

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

COMMONWEALTH EDISON COMPANY :
 : **Dkt. 05-0597**
Proposed general increase in rates for delivery service. :

**INITIAL BRIEF OF THE
ILLINOIS INDUSTRIAL ENERGY CONSUMERS**

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INITIAL BRIEF OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS

A diverse group of large electricity consumers, Abbott Laboratories, Inc., Caterpillar Inc., Citgo, Inc., Corn Products International, Inc., Daimler Chrysler Corporation, Ford Motor Company, International Steel Group, Merchandise Mart, Sterling Steel, LLC, and Thermal Chicago, Inc., as well as the University of Illinois, participated in this case. They will refer to themselves as the Illinois Industrial Energy Consumers (“IIEC” or “IIEC Companies”). Pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission (“ICC” or “Commission”) (83 Ill. Adm. Code Part 200.800), and the briefing schedule set by the Administrative Law Judges (“ALJs”), the IIEC Companies named above present their Initial Brief in this docket for the Commission’s consideration.¹

I.

INTRODUCTION

This proceeding was initiated by Commonwealth Edison Company (“ComEd” or “Company”) when it filed for modification of certain rates and tariffs and a general increase in its delivery service rates. ComEd proposes to increase the delivery service rates, which were set recently by the Illinois Commerce Commission (“Commission”) in Commonwealth Edison Company Docket No. 01-0423 on March 28, 2003, by \$317.85 million (Hill ComEd Ex. 5.1, App. A, Sch. A-1), and modify various rate structures and conditions.

¹ This Brief follows the agreed upon outline for the briefs in this proceeding. However, it only uses captions relevant to issues addressed by IIEC. IIEC has some additional subsections under the agreed upon outline captions to better organize the brief.

The Company's revenue request in this case is based in substantial part on overstated amounts of Administrative and General expense ("A&G") and General and Intangible ("G&I") plant. This overstatement of the revenue requirement is aggravated by the Company's proposed ratemaking capital structure for delivery service. This capital structure includes a substantial amount of equity capital that is not associated with any delivery service assets and, therefore, is inappropriately included in the Company's ratemaking capital structure. The Company also seeks a return on common equity and an overall rate of return well in excess of market requirements.

One of the major features of ComEd's delivery service rate case is its proposal to combine all standard voltage delivery service customers with demands of 1 MW or more into a single rate class. ComEd's current granular rate structure was approved as just and reasonable in ComEd's last two delivery service cases, Docket No. 01-0423, and Docket No. 99-0117. As approved, the current rate structure contains four separate rate classes for these customers. In addition, ComEd proposes to alter the definition of Maximum Kilowatts Delivered ("MKD"). Under the new definition, the MKD for a customer would be determined on the basis of the customer's highest demand in any 24-hour period, instead of its highest demand during the peak period (6:00 a.m. to 10:00 p.m.).

ComEd also proposes to implement a new Rider RESALE to replace current Rider 12 - Conditions of Resale or Redistribution of Electricity by Customer to Third Persons - and a new Rider ZSS7, limiting its availability and imposing new restrictions on cogeneration and self-generation customers. The Company further proposes to implement a new Rider ECR - Environmental Cost Recovery Rider which is unnecessary and certainly relates to an overly broad category of costs.

The Commission Staff (“Staff”) proposes to modify the Company’s rate design to shift 20% of customer costs from the customer component of ComEd’s delivery service rates to the usage and demand components. According to the Staff, this change would reflect a cost (environmental) of producing power in ComEd’s delivery service rates.

ComEd proposes to use an embedded cost of service study (“ECOSS”) to set rates. The study fails to establish the cost to serve existing customer classes providing no support for consolidation of existing rate classes. It also fails to consider that a substantial portion of the distribution system is customer related in developing cost of service. Other parties inappropriately propose to allocate the demand related (non-usage sensitive) cost of the distribution system on a per kWh basis and to make revenue allocations in this case on the basis of hypothetical or speculative class risk differentials.

IIEC Companies are concerned about the Company proposals discussed above as well as certain proposals made by other parties and the Staff. These proposals, if adopted, will affect the price ComEd’s largest customers pay for the delivery of electric power and energy. Given the magnitude of electricity consumed by IIEC Companies, they are likely to be affected to a greater degree by the Commission’s decision in this case than other groups of customers. IIEC Companies are a fundamental and important part of the economy of northern Illinois. They employ thousands of the customers who are also affected by the ComEd proposal.

IIEC has presented the testimony of Mr. Robert R. Stephens, Mr. Michael P. Gorman, Mr. Brian Janous and Mr. Alan Chalfant of the firm of Brubaker & Associates, Inc. (“BAI”). These gentlemen and their firm have extensive experience in the areas of energy procurement and public

utility regulation. BAI provides service to industrial and institutional customers, and on occasion, state regulatory agencies. BAI provides analysis of electric rates. It prepares rate, feasibility, economic and cost of service studies relating to energy and utility services. BAI has also prepared depreciation and feasibility studies relating to utility service. (*See* Stephens IIEC Ex. 1.0, App. A at 2:531-537).

Mr. Stephens is a former member of the Illinois Commerce Commission Staff. As a Senior Economic Analyst in the Planning and Operations Department he reviewed utility filings and offered testimony on behalf of Staff. As a Commissioner's Assistant he provided technical and policy analysis to the Commission. He holds a Master of Business Administration Degree from the University of Illinois at Springfield. Mr. Stephens has been an employee at BAI since 1997. (Stephens IIEC Ex.1.0, App. A at 1-2:518-530).

Mr. Gorman is a principal in the BAI firm. He is also a former member of the Illinois Commerce Commission Staff where he was last employed as Director of the Financial Analysis Department. He is a former employee of Merrill-Lynch as a financial consultant. While employed at BAI, he has testified on cost of capital, utility merger and acquisitions, utility reorganizations, utility operating expenses and rate base. He also holds a Master of Business Administration Degree from the University of Illinois at Springfield. (Gorman IIEC Ex. 3.0, App. A at 1-2:1201-1231).

Mr. Chalfant is also a principal in the BAI firm. He has previously testified before the Federal Energy Regulatory Commission and more than thirty state public utility commissions. He holds a Master of Arts in Economics from Washington University. He is a former Assistant Professor of Economics at California State University at Northridge where he taught courses in

Economics of Antitrust and Regulation at both graduate and undergraduate levels. He is a former member of the Staff of the Public Service Commission of Wisconsin in the Utility Rates Division. He has been with BAI and its predecessor, Drazen-Brubaker & Associates, since 1974. (Chalfant IIEC Ex. 2.0, App. A at 1:318-326).

Mr. Janous is a summa cum laude graduate from the University of Missouri and holds a degree of Master of Business Administration from Webster University. He joined the BAI firm in 2000. There he has participated in electric cases and assisted in the development of cost of capital analysis and testimony. (Janous IIEC Ex. 4.0, App. A at 1:128-137).

IIEC Companies have carefully considered the issues discussed above. They have made specific recommendations to the Commission in this proceeding. They oppose ComEd's requested 222% increase in G&I plant. They recommend a level of G&I 24.5% greater than the level the Commission approved in the most recent ComEd case.

IIEC Companies oppose ComEd's requested 55% increase in A&G expense (or overhead). They recommend the Commission maintain the traditional relationship between A&G and other Operating and Maintenance (O&M) expense (excluding A&G expense) established in ComEd's last case.

IIEC's approaches to establishment of the appropriate level of G&I and A&G have been previously approved by the Commission and affirmed on appeal by a reviewing court. (Chalfant, Tr. 1699).

IIEC recommends and strongly endorses the use of the Staff's proposed capital structure for ratemaking purposes in this case. Staff recommends a capital structure consisting of 37.11%

common equity and 62.89% debt. IIEC also recommends a return on common equity (“ROE”) of 9.9% for ComEd. This capital structure, together with the recommended ROE, produces an overall return of 7.75% for ComEd, which is appropriate in this case.

In addition, while the Company has presented an ECOSS that generally follows accepted principles of cost causation, the study fails to follow those principles in one very important respect. It fails to consider the fact that a significant portion of the cost of the distribution system is customer related. Specifically, it fails to reflect the concept of a minimum distribution system. Because it does so, the study may over-allocate costs to larger industrial customers. As a result, IIEC recommends that in the next case, the Commission direct ComEd to reflect the minimum distribution system concept in its cost of service study.

IIEC also recommends that proposals to allocate electric distribution costs on the basis of kWh and proposals to allocate revenue on the basis of hypothetical or speculative class risk differentials be rejected.

IIEC opposes the Company’s proposal to consolidate all four of the current non-residential rate classes of customers 1 MW and more into a single rate class, the Very Large Load Delivery Class. The Company failed to present in this case, a valid cost of service study that developed costs by existing customer classes. Such a study would be needed to determine whether any of the present non-residential classes currently have a similar cost of service that justifies such class consolidation. The Company’s proposal is also inconsistent with prior Commission determinations, and the evidence of record, which shows the 10 MW and over class of customers has a lower cost per kW than the three smaller non-residential classes. While IIEC would not oppose the

combination of the three smaller non-residential classes, i.e., 1-3 MW, 3-6 MW and 6-10 MW, it recommends that a separate class be maintained for 10 MW and over customers.

Under the circumstances, the rates applicable to 10 MW and over customers, both at standard voltage and at high voltage (69 kV and higher), should be based on the current (taking effect June 2006) rates and increased or decreased in proportion to the overall revenue increase or decrease approved by the Commission in this case.² At ComEd's requested increase in revenue requirement, this would result in a 24.8% increase in these rates.

ComEd's proposed change in the definition of MKD should be rejected and the current definition retained. ComEd has failed to provide sufficient justification for its change. In making this proposal ComEd did not address detriments associated with the change, such as the dramatic and indefinite cost increases for some customers. Nor did ComEd consider the adverse impact of discouraging customers from operating exclusively or primarily in off-peak periods or the potential confusion and increased customer operating costs resulting from its proposed change.

ComEd's proposed Rider ZSS7 should be modified to make it applicable to cogeneration or self-generation customers who currently have the option to elect existing Rider ZSS. Should ComEd's MKD be adopted, Rider ZSS7 should be made available to all customers with cogeneration or self-generation.

The Company's proposed Rider RESALE should be modified, as agreed by the Company in its rebuttal testimony, to clarify that all legitimate costs associated with the resale or redistribution

² The RCDS Phase-In

of electricity can be recovered by customers who are permitted to resell or redistribute electricity under Rider RESALE.

ComEd's proposed Environmental Cost Recovery Rider - Rider ECR - should be rejected. ComEd should be permitted to reflect the appropriate level of the subject costs in base rates.

IIEC recommends that Staff witness Lazare's proposal to modify the Company's delivery service rate design to include 20% of customer costs in the usage or demand charge components of the delivery service rates be rejected.

III.

ARGUMENT ON CONTESTED ISSUES

B. Rate Base

2 & 3. General Plant and Intangible Plant - Functionalization and Amount

ComEd seeks to reflect General and Intangible ("G&I") Plant of \$496.4 million in its rates. This represents a 222.2% increase over the \$223.4 million of G&I Plant approved in the Company's last delivery service rate case, Docket No. 01-0423. (Chalfant IIEC Ex. 2.0 at 3:Table 1). In this case IIEC recommends the Commission approve a level of G&I Plant equal to the percent increase in net distribution plant approved for ComEd. (Chalfant IIEC Ex. 2.0 at 8:138-149). Assuming ComEd's original requested level of distribution plant, the level of G&I Plant approved by the Commission in this case would be limited to \$278.1 million. (Id.).

IIEC's proposal is appropriate for several reasons. First, the magnitude of the requested increase in G&I Plant is not reasonable. In describing methods for allocating G&I plant, ComEd witnesses have testified that G&I Plant can house administrative and general-type activities such as

administration of employee pensions and benefit plans and employee training. They have testified that much of this type of plant seems to be directly involved in supporting other plant investment. (Heintz ComEd Ex. 11.0 at 14:298-309; *See also*, Chalfant, IIEC Ex. 2.0 at 7:125-130). ComEd witnesses have also testified that utility plant accounts representing equipment, tools and stores seem, intuitively, to be related to the amounts of production, transmission and distribution plant owned by the utility. (Chalfant IIEC Ex. 2.0 at 7:134-137). Under such circumstances, it is hard to comprehend why G&I Plant would increase by 222% while the cost of the Company's distribution plant has increased by only 24.5% and the Company's O&M expenses have decreased by 12.5%. (Chalfant IIEC Ex. 2.0 at 7:131-133 and IIEC Ex. 2.0 at 3:Table 1). Given the relationship between the level of distribution plant and O&M expenses to the level of G&I Plant, it is not reasonable that ComEd's G&I Plant would increase by 222.2% over levels approved in the last case.

Second, while ComEd has explained the content of each of the affected G&I Plant accounts, it has not explained how or why G&I Plant has increased by 222.2% over levels approved in the last case. Therefore, ComEd's proposed level of G&I Plant should not be approved in this case. Instead, the appropriate level of G&I Plant in this case should be based on the percentage increase in distribution plant authorized in this case as recommended by IIEC.

C. Operating Expenses

3. Administrative and General Expense

a & b. Functionalization and Overall Amounts

Administrative and General (“A&G”) expenses are principally related to the corporate activities of the utility, such as salaries of corporate officials, pensions and benefits, injuries and damages, office supplies and miscellaneous expenses. They are sometimes referred to as “overhead.” (Chalfant IIEC Ex. 2.0 at 4:67-70). ComEd proposes to reflect \$274 million of these overhead expenses in its delivery service rates. This increase in overhead represents an increase of \$97.3 million or 55% over the levels authorized in the Company’s last rate case. This represents over one-quarter of the total increase requested by ComEd in this proceeding. (Chalfant IIEC Ex. 2.0 at 4:72-74 and 5:84-85 and 3:Table 1).

IIEC recommends a level of A&G expense based on the percentage increase or decrease in O&M expense, other than A&G, ultimately approved in this case. This would maintain the relationship between overhead and O&M expenses that resulted from the Commission’s rate order in ComEd’s last delivery service rate case. Under this approach, if ComEd’s requested level of O&M, other than A&G, is adopted in this proceeding, ComEd would require a level of overhead expense in this case of \$155.4 million. This would reduce ComEd’s revenue requirement by approximately \$119 million. (Chalfant IIEC Ex. 2.0 at 6:102-109).

IIEC’s recommendation should be adopted for several reasons. First, in the last case, both Staff and IIEC recommended the Commission reduce ComEd’s A&G expense for the delivery service function. (Chalfant IIEC Ex. 2.0 at 3:53-54). The Commission specifically approved \$176.7

million as the reasonable A&G level for ComEd's 2000 test year. (ComEd, ICC Dkt. 01-0423, March 23, 2003 Order, App. A, Sch. 1). In the last case, the Commission also determined that ComEd's O&M expense (other than A&G) for the 2000 test year should be \$493.7 million. (Chalfant IIEC Ex. 2.0 at 4:60-65).). Therefore, the Commission's Order in the last case had the net effect of approving 35.8 cents of A&G, or overhead expense, for every dollar of O&M expense other than A&G. ComEd has provided no rationale or justification for an increase in its overhead expenses to 63.2 cents per dollar of O&M, other than A&G. (Chalfant IIEC Ex. 2.0 at 5:89-91) IIEC's proposal maintains the relationship between A&G and O&M, other than A&G, established in the last case.

ComEd did not compare its proposed level of A&G to past levels of A&G. Also, ComEd did not compare its proposed level of A&G to the level of O&M it is requesting in this case. (Chalfant IIEC Ex. 2.0 at 5:78-81). In this case ComEd, not intervenors, has the burden to prove the justness and reasonableness of its rates. (*See*, 220 ILCS 5/9-201(c); City of Chicago v. People of Cook County, et al., (1st Dist. 1985) 133 Ill. App. 3d 435, 478 N.E. 2d 1369, 1375). In failing to compare levels of A&G in this case with the A&G levels in the last case, and failing to compare the level of A&G requested in this case to the level of O&M, other than A&G, requested in this case, ComEd has failed to meet its burden.

Therefore, to the extent the Commission approves an increase or decrease in the level of O&M, other than A&G, needed for delivery service in this case, the level of A&G or overhead expense should be increased or decreased proportionately. This will maintain the relationship of 35.8 cents of overhead for every dollar of O&M, other than A&G, that exists in current rates.

E. Rate of Return

1. Capital Structure

ComEd has proposed a capital structure made up of 54.2% common equity and 45.8% debt to develop its overall cost of capital. (Mitchell ComEd Ex. 7.1, Sched. D-1). IIEC witness Gorman opposed that capital structure as too heavily weighted with equity, which is more costly for ratepayers. (Gorman IIEC Ex. 3.0 at 2:21-23, 17:390). After considering the evidence, the testimony of other experts, and the arguments of all parties, in his rebuttal testimony Mr. Gorman found that Staff's proposed capital structure was the best proxy of ComEd's total capital supporting the utility's delivery services.³ He recommended adoption of Staff's capital structure -- 37.11% equity and 62.89% debt. (Gorman IIEC Ex. 7.0 at 2:33-40). That structure is the result of including only equity that actually supports assets used in providing ComEd's delivery services. (Gorman IIEC Ex. 7.0 at 6:124-131). Staff's proposed capital structure should, therefore, be used to develop ComEd's overall rate of return for its delivery services.

³ In rebuttal, Mr. Gorman accepted the Staff's better representation of the investment actually supporting ComEd's delivery services. (Gorman IIEC Ex. 7.0 at 6:125). IIEC originally recommended use of a 50% equity-50% debt capital structure, developed by rejecting 100% common equity financing of ComEd's portion of Exelon's total pension fund contribution (Gorman IIEC Ex. 3.0 at 2:25, 18:425). Since Exelon actually funded its consolidated pension contribution with a mix of debt and tax savings, not equity, the corporate decision to treat ComEd's portion of that contribution as equity inflated the actual cost of that capital for ratemaking purposes and was not just and reasonable. (Gorman IIEC Ex. 3.0 at 2:25-30). After further analysis of the issue, Mr. Gorman concluded that ComEd did not fully remove the common equity supporting goodwill from its proposed ratemaking capital structure. Therefore, for the reasons set out in this brief, Mr. Gorman changed his position on capital structure to support Staff's proposed capital structure.

Both Staff and IIEC pursued a common objective -- “developing a capital structure for ComEd . . . to identify the amount of common equity and debt that now support ComEd’s transmission and distribution utility assets.” (Gorman IIEC Ex. 7.0 at 7:147-149; Gorman, Tr. 2051). However, as Mr. Gorman stated in his Rebuttal testimony and his oral testimony, Staff and IIEC support that common capital structure with distinct, independent (yet complementary) analyses. (Gorman IIEC Ex. 7.0 at 8:172-177; Gorman Tr. 2051). (The Staff and IIEC analytical approaches are plainly distinguished in Mr. Gorman’s testimony at Tr. 2051-2058 and IIEC Redirect Ex. 1.)

a. Staff and IIEC Employed Distinctive, Complementary Analyses to Support A Common Recommended Capital Structure

Staff. Staff’s approach to ComEd’s proposed capital structure removes the amount of common equity supporting a Goodwill asset created at the time of the Unicom-PECO merger. (Gorman IIEC Ex. 7.0 at 3:53). Ms. Kight examines how the Commission properly should treat the goodwill accounting asset created by a corporate decision to use purchase accounting in the Unicom-PECO merger.

Ms. Kight’s discussion of proper goodwill accounting begins with a generally applicable statement of principle:

Since rates are based on original cost rate base, capital structure should also reflect the amount of capital originally invested in a utility’s assets (assuming that capital structure is reasonable from a cost standpoint), not reassessments of the fair value of the capital invested.

(Kight Staff Ex. 4.0 at 5:85-88). She concludes, however, that on the peculiar circumstances of this case, reversing ComEd’s previous write-down of generation assets as ComEd proposed would be

inappropriate (Kight Staff Ex. 4.0 at 5:91-101; Houtsma, Tr. 513:15), and she rejects ComEd's reliance on flawed accounting mechanics.

In effect, Ms. Kight explains, ComEd wrongly proposes to reverse only one-half of the merger transaction. ComEd would restore the original asset cost for ratemaking, but, as Ms. Kight points out, the utility and its ratepayers would not receive or retain "assets equal to the pre-write down value for that plant." (Kight Staff Ex. 4.0 at 5:92). Ms. Kight develops a more complete accounting for the goodwill and equity effects created by the corporate decision to use purchase accounting. By overstating the amount of capital in use for providing ComEd delivery services, ComEd's proposal would leave the burden of recovering the original cost of the generation assets on delivery service ratepayers, while ComEd's generation affiliate would retain the advantage of an asset transfer at the lower, reassessed value instead of original cost.

ComEd. For its part, ComEd appears to take a more mechanical approach to the accounting issues Ms. Kight addresses. However, ComEd obscures the reality of its proposed goodwill accounting with misleading illustrations that do not represent ComEd's actual capital structure or accounting. (*See, e.g.*, ComEd Redirect Ex. 1; Houtsma, Tr. 481:15; Tr. 483:6-9 ("assume that ComEd's equity balance was \$6 billion".)) When one examines ComEd's actual book entries, the illusion of simple arithmetic underlying ComEd's proposed adjustment disappears.

The accounting dispute between Staff and ComEd was summarized in Mr. Gorman's rebuttal testimony. (Gorman IIEC Ex. 7.0 at 3-4:50-102). However, in IIEC's view, the Commission should not give excessive weight to technical accounting mechanics to determine the equity component of the proper capital structure. (Gorman, Tr. 2053-2054). The Commission should not lose sight of

the core issue: What is a reasonable cost capital structure that reflects the investment actually supporting ComEd's delivery services assets and operations?

IIEC Companies. Mr. Gorman's approach to this question, which is distinct from the accounting exercise advocated by ComEd and from Ms. Kight's qualified usage of accounting concepts, goes directly to the core issues. The Commission must determine a capital structure that is reasonable and that reflects the capital supporting its regulated delivery service assets and operations. (Gorman IIEC Ex. 7.0 at 233.)

ComEd's goodwill asset is not a transmission or distribution asset. (Gorman IIEC Ex. 7.0 at 8:173; Houtsma, Tr. 409-410). And, it is not used in providing ComEd's delivery services; indeed, ComEd has excluded it from its proposed rate base in this case. (Houtsma, Tr. 426:16). Consequently, the common equity recorded when that goodwill asset was created is not capital that supports the rate base and services under Commission regulation. ComEd's goodwill must be supported by equity, since "goodwill does not produce revenues and cash flows, and therefore could not be supported by debt capital." (Gorman IIEC Ex. 7.0 at 8:185 *citing* ComEd response to IIEC DR 4.01(d); Gorman, Tr. 1986). Accordingly, the equity supporting ComEd's goodwill should be excluded from the capital structure used to determine ComEd's delivery services revenue requirement.

Excluding this equity results in a total capitalization that reasonably reflects ComEd's total rate base and a capital structure that reflects the sources of capital supporting delivery services. In contrast, ComEd includes equity that is not dedicated to the provision of delivery services in its proposed capital structure, unreasonably inflating the utility's revenue requirement as a result.

Mr. Gorman summarized his analysis of ComEd's proposed capital structure and the basis for his recommendation in his oral testimony.

Q. . . . Could you tell me the approach that you took?

A. Yes. Again -- and I think I had the same objective as Staff witness Ms. Kight's had, and that was to identify the amount of Commonwealth Edison's capital that supports its regulated transmission and distribution utility rate base. And I did that by first looking at the total capital upon ComEd's balance sheet and that was over \$11 billion. I looked at the test year rate base, that was \$6 billion. Clearly, you don't need \$11 billion of capital to finance a \$6 billion rate base. So my next question was, Well, what's the difference? What's the major difference between rate base and capital? The major difference was a good will asset of about \$4.9 billion. The evidence in the record clearly shows that that \$4.9 billion good will asset is financed entirely by common equity. So that good will is not a transmission distribution asset, it's financed with common equity, it's appropriate to carve that common equity out of capital structure and attribute it only to the good will asset. . . . So when you take the common equity of ComEd of \$11 billion of capital and attribute that to the good will asset, you are left with approximately 6 to \$7 billion in capital to finance a \$6 billion rate base. And that's typical of what one normally receives in reviewing the utilities actual capital structure and rate. They don't always match, but they're generally pretty close. So in order to identify the capital on ComEd's balance sheet that supports utility rate base, I found it appropriate to remove the common equity supporting the good will asset

(Gorman, Tr. 2051-2053). Mr. Gorman concluded with his recommendation for the appropriate capital structure for ratemaking purposes in this case.

Since the objective in this proceeding is to measure, Commonwealth Edison's cost to providing regulated utility service, it's appropriate to look at its total capital, identify what part of that capital represents its cost of funding utility plant investments. And the capital structure proposed by Staff witness Ms. Kight and supported by myself is the proper assessment of that capital supporting regulated utility rate base.

(Gorman, Tr. 2054).

Ms. Kight's analysis seeks an appropriate accounting for the goodwill created by the corporate decision to use purchase accounting. She concludes that goodwill (and the equity supporting it) should be excluded from the ratemaking capital structure. On the basis of his distinct evaluation of ComEd's proposed capital structure, Mr. Gorman reached the same conclusion. (Gorman, Tr. 1985, 1988:6-15). Accordingly, he supports Ms. Kight's recommendation. (Gorman IIEC Ex. 7.0 at 2:18). Though they support the same recommendation, Mr. Gorman and Ms. Kight took different, independent paths to that recommendation. (Gorman, Tr. 1988, 2056). Each analysis supports rejection of ComEd's proposed capital structure.

*b. The Commission's Proper Focus Should Be Determining
A Cost of Service Based Capital Structure*

As Mr. Gorman explained, defining an appropriate capital structure is part of determining the utility's cost of providing regulated delivery services. (Gorman, Tr. 2055). The Commission must identify, separately, the utility's reasonable asset and operating costs incurred to provide delivery services -- *i.e.*, a cost of service based capital structure. Those separately identified amounts -- which exclude imprudent, unreasonable, and not used or useful costs -- are the bases for calculating a delivery services revenue requirement that provides ComEd a return on its delivery services rate base assets and recovery of its delivery services operating expenses.

Mr. Gorman sponsored an illustrative exhibit (IIEC Redirect Ex. 1 (Fig. 1, *infra*) to help explain why a deliberate determination of a reasonable capital structure that actually supports ComEd's transmission and distribution assets and operations is the Commission's proper focus. That exhibit (shown immediately below) demonstrates why the equity supporting ComEd's goodwill

asset is properly excluded from the utility’s delivery services capital structure, regardless of accounting treatment.

| COMMONWEALTH EDISON COMPANY | | | |
|--|---|------------------|---------------------------------------|
| <u>Capital Supporting T&D Rate Base</u> | | | |
| Line | Test Year | Amount (000) | Source |
| 1 | Total Unadjusted Capital ^(a) | \$11,874,770 | ComEd Ex. 7.1, Schedule D-1 and WPD-1 |
| 2 | T&D Rate Base | <u>6,189,171</u> | Schedule A-2 |
| 3 | Incremental Capital Above Rate Base | 5,685,599 | Line 1, less Line 2 |
| 4 | Good Will/Other Intangibles | 4,926,000 | ComEd Ex. 7.0 at 7 |
| 5 | Incremental Capital Excluding Good Will | 759,599 | Line 3, less Line 4 |
| <hr/> <small>^(a) Total Capital \$9,582,770, add book common equity adjustment of \$2,292,000 made on WPD-1.</small> | | | |

Figure 1

Line 1 of the exhibit shows ComEd’s total outstanding capital (debt and common equity), as reported in ComEd witness Mr. Mitchell’s schedule supporting his proposed capital structure -- with one adjustment. The adjustment adds back the \$2.292 billion of common equity Mr. Mitchell recommended removing from ComEd’s common equity balance to produce the Company’s proposed capital structure. (Mitchell ComEd Ex. 7.0 at 7:135). When ComEd’s \$2.292 billion adjustment is restored, the result is ComEd’s total test year common equity of \$11.874 billion. ComEd is proposing a test year rate base of \$6.189 billion. The \$5.685 billion difference between the amount

of capital shown in the Company's filing and its proposed test year rate base clearly is not used to support T&D services. The difference is accounted for mostly by equity supporting the goodwill asset, for which ComEd's books show a balance of \$4.926 billion. Since the goodwill asset is distinct from ComEd's delivery services rate base, it is important to remove the common equity supporting that goodwill, so that the capital included in the capital structure is capital actually used to provide regulated transmission and distribution utility services. (See IIEC Redirect Ex. 1; (Gorman) Tr. 2056-2058).

At the end of the day, the issue before the Commission is identification of a reasonable capital structure that reflects the sources of capital supporting the provision of ComEd's regulated delivery services. The relevant question in this regard is what amount of investment actually supports ComEd's provision of Illinois delivery services.

3. Cost of Common Equity

ComEd overestimates its required return on common equity and requests an authorized equity return of 11%. (Hadaway ComEd Ex. 8.0 at 1:16-18). IIEC, through its witness Mr. Gorman, recommends a return on common equity ("ROE") of 9.9%, which Mr. Gorman found adequate to support ComEd's credit rating and its financial integrity. (Gorman IIEC Ex. 7.0 at 16:360).

IIEC's recommendation is based on Mr. Gorman's multi-faceted analysis, which considered the results of a constant growth discounted cash flow model ("DCF"), a risk premium model ("RP"), and a capital asset pricing model ("CAPM").⁴ These three analytical models, each of which was

⁴ IIEC's recommendation is based on these results of Mr. Gorman's models: DCF (9.7%); RP (10.2%); and CAPM (10.2).

used by at least one other ROE witness in this case, have been employed regularly in Illinois regulatory proceedings. (*See, e.g.*, Order, Dkt. 01-0423, Commonwealth Edison, issued March 28, 2003 at 131; Order, Dkt. 04-0779, Nicor Gas, issued September 20, 2005 at 75 *et seq.*).

Staff is proposing a common equity return of 10.19%. (McNally Staff Ex. 5.0 at 2:23). Staff witness Michael McNally relied on a DCF model return of 9.36% and a RP (CAPM) model result of 11.01%. (McNally Staff Ex. 5.0 at 17-18:331-333).

ComEd's witness Dr. Samuel Hadaway, who also conducted multiple studies,⁵ recommended an excessive 11.0% return on common equity. Virtually every cost estimate made by Dr. Hadaway was overstated and flawed. However, Mr. Gorman showed that using reasonable estimates, and excluding Dr. Hadaway's unreasonable add-on premiums, Dr. Hadaway's own analysis would support a return on equity under 10.0% as reasonable for ComEd. (Gorman IIEC Ex. 3.0 at 39:882-885 and 40:Table 3).

a. Discounted Cash Flow (DCF) Model

The DCF model posits that a stock is valued by summing the present value of its expected future cash flows, discounted at the investor's required rate of return ("ROR") or cost of capital. The model's basic equation can be arranged to estimate the investor required return on an equity

⁵ Dr. Hadaway relied on two versions of a constant growth DCF model. The first used consensus analysts' growth rates and produced results in the range 9.2% to 9.3%. His second relied on a GDP growth rate of 6.6% and produced a return in the range 11.1% to 11.2%. Dr. Hadaway also used a two-stage DCF model that produced results in the range 8.2% to 10.6%. Dr. Hadaway's risk premium study based on projected interest rates indicated a return in the range 10.7% to 10.8%. Dr. Hadaway also performed risk premium studies based on an Ibbotson risk premium study and Marston risk premium studies, which produced risk premium estimates in the range 10.9% to 12.6%. Dr. Hadaway's CAPM analysis indicated a return of 10.4% to 10.8%. (Hadaway ComEd Ex. 8.0 at 39:892-893).

investment. The constant growth rate DCF model, which assumes dividends grow at a constant rate, is expressed mathematically as follows:

$$K = D_1/P_0 + G$$

where: K = the investor's required return;
D₁ = dividends in the first year;
P₀ = current stock price; and
G = expected constant dividend growth rate.

(Gorman IIEC Ex. 3.0 at 22:500-504).

The primary disputed DCF model input in this case is the growth rate. To estimate "G" (the expected constant growth in dividends), Mr. Gorman used the consensus estimate of investment analysts of the expected growth rate. (Gorman IIEC Ex. 3.0 at 23:536). With this input, his constant growth DCF model yielded a range of 9.3% to 9.4% for the return on common equity. Mr. Gorman selected 9.4% from that range as his DCF return on common equity. Consistent with past Commission practice, Mr. Gorman then adjusted the results of his constant growth DCF formula to recognize quarterly compounding. As adjusted, his DCF analysis produces a recommended return on common equity of 9.7%. (Gorman IIEC Ex. 3.0 at 25:570-572).

In ComEd's view, the alleged problem with Mr. Gorman's analysis "can be traced to his sole reliance on analysts' growth rate estimates to determine the growth rates for his DCF model," giving no weight to long-term growth forecasts. (Hadaway ComEd Ex. 21.0 at 11:240). However, Mr. Gorman had earlier explained the merit of his decision to use analysts' growth estimates.

Security analysts' growth estimates have been shown to be more accurate predictors of future returns than growth rates derived from historical data because they are more reliable estimates, and assuming the market generally

makes rational investment decisions, analysts' growth projections are the most likely growth estimates that are built into stock prices.

(Gorman IIEC Ex. 3.0 at 23:531-535 (footnote omitted)).

He explained further that the consensus analysts' growth rates (4.67% and 4.42%) for the proxy groups he and ComEd used (Gorman IIEC Ex. 3.0 at 25:581-582):

“are . . . reasonably consistent with five-year projected GDP growth of 5.3%, and considerably higher than the five-year projected GDP inflation growth of 2.4%. . . . Utilities' dividend growth cannot sustain a growth rate that exceeds the growth rate of the overall economy. The growth rate of the utility's service territory is the proxy for the sustainable long-term growth rate of earnings.”

(Gorman IIEC Ex. 3.0 at 25-26:585-587 (footnote omitted)).

The growth estimate Mr. Gorman used “. . . is conservatively high, based on virtually every logical and verifiable assessment of long-term sustainable DCF growth.” (Gorman IIEC Ex. 7.0 at 17:380). He describes the input as conservative because

. . . historically these utilities' dividend growth has not exceeded the rate of inflation. In contrast, my analyst-projected growth is approaching two times the projected rate of inflation of 2.5%. Also, analyst growth rate projections are near consensus economists' projections of long-term GDP growth of 5.5%. This is conservative based on historical comparisons. Historically, utility earnings and dividends have grown at a rate much slower than GDP growth.

(Gorman IIEC Ex. 7.0 at 17:384).

ComEd's DCF analysis rejects the use of economists' current, published consensus assessment of GDP growth for the period when the rates determined in this case will be in effect in favor of historical growth rates that inflate the resulting DCF estimate of ComEd's required return on common equity. An appropriate growth rate must estimate investors' expected growth rate, and

not that of the analyst offering testimony. That misguided preference is the genesis of Dr. Hadaway's overstated DCF return estimate. Dr. Hadaway's 6.6% growth rate estimate is significantly in excess of the consensus of projected economists' growth rates for GDP of 5.5% for the next five to ten years. Based on historical data, it incorporates inflation at a level that does not reflect forward-looking expectations.⁶

As demonstrated in IIEC Exhibit 7.4, using the consensus economists' projected GDP growth rate in Dr. Hadaway's DCF analysis would lower his average DCF return estimate from 10.6% to 9.8%, in line with the estimates of both Staff's Mr. McNally and Mr. Gorman. (Gorman IIEC Ex. 7.4 at 1). To attain his version of theoretical accuracy over an infinite period, Dr. Hadaway's model would inject overstated equity costs into next year's delivery services rates.

Mr. Gorman's conservative growth variables reflect the conditions most likely to prevail while the rates determined in this case will be in effect. Over the longer term, ComEd is unlikely to suffer inadequate returns, since the utility can be expected to file for changes in its authorized return and its delivery service rates if there is a significant variance from current growth projections. (Gorman IIEC Ex. 7.0 at 25:593).

Mr. Gorman's DCF analysis estimates ComEd's required return on equity on the basis of relevant economic factors likely to prevail during the period rates determined in this case are in effect. ComEd's proposed analysis uses historical data that unreasonably denies its customers any

⁶ Mr. Gorman demonstrated that Dr. Hadaway's 6.6% GDP growth forecast reflects inflation expectations of approximately 3.2%. This inflation expectation, realized in the past, significantly exceeds forward-looking GDP inflation. (Gorman IIEC Ex. 3.0, 41-42).

benefit of today's (and likely tomorrow's) reality. The Commission should accept Mr. Gorman's analysis estimating ComEd's required return on common equity.

b. Risk Premium (RP) Model

The risk premium model is based on the principle that investors require a higher return to assume a greater risk. Common equity is viewed as having greater risk than corporate bonds. Under the RP model, the risk premium representing the greater risk of equity in comparison to bonds may be calculated in two different ways: (a) as the difference between the required return on utility common equity investments and a U.S. Treasury bond; and (b) as the difference between the return on equity approved for utilities by regulatory commissions and the return on contemporary utility bonds. IIEC's Mr. Gorman used both methods and developed an RP return on common equity recommendation of 10.2%, which was considered along with his DCF and CAPM model results in determining his final ROE recommendation.

ComEd questioned Mr. Gorman's analysis because he declined to make several baseless adjustments that inflate Dr. Hadaway's RP Estimate. Mr. Gorman used a combination of current and projected interest rates; Dr. Hadaway relies entirely on projections. In addition, Dr. Hadaway increases his claimed equity risk premium from 3.08% to 4.4% based on an alleged inverse relationship between interest rates and risk premiums, thus increasing ComEd's recommended equity cost. Mr. Gorman rejected this adjustment because it relies on projected interest rates rather than current observable interest rates. Such reliance is misplaced because the accuracy of projected interest rates is highly problematic. (Gorman IIEC Ex. 7.0 at 18:414-432; IIEC 3.0 at 44-47:954-1045). Mr. Gorman relies on actual observable bond yields, while Dr. Hadaway's RP study uses his

own idiosyncratic projection of bond yields. Mr. Gorman's RP analysis is more reasonable and merits the Commission's reliance.

Projected Interest Rates. Mr. Gorman's use of a combination of projected and current, observable interest rates was carefully considered and fully justified. Mr. Gorman conducted an extensive analysis of interest rate data to answer the question whether the Commission should follow Dr. Hadaway's lead and accept interest rate projections over "observable and verifiable" interest costs. (Gorman IIEC Ex. 3.0 at 11:270). Mr. Gorman concluded that "[w]hile projected interest rates should be given some consideration, the determination of ComEd's cost of capital today should be based primarily on observable and verifiable actual current market costs. This is appropriate because projected changes to interest rates are highly uncertain and the accuracy is at best problematic." (Gorman IIEC Ex. 3.0 at 11:268-272). The results of his analysis are presented in his Schedule MPG-1. From his analysis of interest rate data, Mr. Gorman concluded:

This review of the experience with projected interest rates clearly illustrates that interest rate projection accuracy is highly problematic. Indeed, current observable interest rates are just as likely a reasonable projection of future interest rates as are economists' projections. Accordingly, while I will use projected interest rates to provide some sense of the market's expectations of future capital market costs in my models, I will not use them exclusively.

(Gorman IIEC Ex. 3.0 at 12:291-296). "I choose to be conservative in my analysis by considering both current and projected interest rates. This reflects a range of possible interest rates during the period rates set in this proceeding are in effect." (Gorman IIEC Ex. 7.0 at 19:430-432).

Considerable protection against increasing costs of capital is inherent in a utility's right to initiate ratemaking proceedings. This effective hedge against increasing costs is additional reason

why there is no need to inject uncertain capital costs into rates. (Gorman IIEC Ex. 3.0 at 13:303). The Commission can be confident that ComEd will act if actual interest rates diverge significantly from current projections. Accordingly, Mr. Gorman's RP model, which does recognize the reality of today's economic conditions and today's investor's expectations should be accepted as the superior analysis.

c. Capital Asset Pricing Model (CAPM)

A CAPM analysis is a specialized form of risk premium analysis. Staff Ex. 5.0 at 9:173. Mr. Gorman developed a CAPM analysis as well as DCF and bond yield RP analyses. Mr. Gorman's CAPM results varied only modestly from his other models; in fact, his CAPM and RP results were identical. (Gorman IIEC Ex. 3.0 at 35:Table 2). The reasonableness of that result was discussed above.

Mr. Gorman's CAPM results were also well inside the range defined by the CAPM result extremes of CUB on the low end and Staff on the high end. (Gorman IIEC Ex. 3.0 at 35, Table 2; CUB-CCSAO-City Ex. 4.0 at 24:Table (Alternative CAPM Estimates)). Accordingly, the debate on CAPM issues has focused on other witnesses' application of this model. To the extent necessary, IIEC will address CAPM issues in its reply brief.

4. Overall Cost of Capital

The overall cost of capital recommendation ties together the determinations of recommended ROE, cost of debt, and capital structure. From his developed range of required equity returns, with 10.2% (CAPM and RP) at the high end and 9.7% (constant growth rate DCF) at the low end, IIEC

witness Gorman recommended a return on common equity for ComEd of 9.9%.⁷ IIEC witness Gorman's recommended 9.9% return on common equity and the Staff's proposed capital structure produces an overall return for ComEd of 7.75%. The body of IIEC's evidence shows that with IIEC's recommended 9.9% ROE and the Staff's capital structure ComEd will be able to maintain its current investment grade bond rating (BBB+) and also have an opportunity to achieve its target bond rating of A.⁸

S&P evaluates credit ratings based on an assessment of the financial and business risk of utilities. S&P publishes a matrix of financial ratios that define the level of financial risk. S&P uses three primary financial ratios to guide its credit review for utility companies: (1) funds for operations ("FFO") to debt interest expense; (2) FFO to total debt; and (3) total debt to total capital.

IIEC witness Mr. Gorman used S&P's financial ratios test to determine the reasonableness of his recommendations. He evaluated whether the rate of return and cash flow generation opportunities reflected in his cost of capital recommendations would support investment grade bond ratings and financial integrity for ComEd. By these measures, his recommended rate of return on common equity and the Staff capital structure, and the 6.5% embedded cost of debt, produced financial ratios that will support ComEd's current BBB+ bond rating and provide ComEd with the opportunity to achieve its target A bond rating.

⁷ IIEC's testimony demonstrates that the cost of equity analysis presented by ComEd's witnesses (when corrected for specific errors in the DCF and RP analyses) supports a recommended ROE in the range of 9.8% to 10.4%, consistent with IIEC's recommended ROE of 9.9%.

⁸ Currently, ComEd has a senior corporate credit rating of A- and a corporate credit rating of BBB+ from Standard & Poors Credit Rating Agency ("S&P").

F. Cost of Service Issues

1. Embedded Cost of Service Study

ComEd recommended the use of an embedded cost of service study (“ECOSS”) in this proceeding for rate design and revenue allocation purposes. (Crumrine ComEd Ex. 9.0 at 43:931-932; Heintz ComEd Ex. 11.2). However, as discussed in Section III.H.1.b.2).(a) below, the study presented by ComEd did not provide information on the cost to serve the existing non-residential customer classes. Furthermore, it did not adopt the concept of the minimum distribution system.

Because the Company’s ECOSS does not provide information on the cost of serving the existing non-residential classes, it cannot be used to justify the combination of those classes into a single class. Nor can it be used for rate design for the 10 MW and over class IIEC recommends be retained in Section III.H.1.b.2).(a) below. Because the Company’s ECOSS does not reflect the minimum distribution concept, the study overallocates the cost to the Very Large Load Class. (*See*, Chalfant IIEC Ex. 2.0 at 15:295-301). Therefore, IIEC recommends ComEd be directed to present a study incorporating the minimum distribution concept in its next delivery service rate case. (*See*, Sec. III.F.2. below). In addition, the Commission should reject proposals to arbitrarily allocate 50% of the cost of the distribution system on the basis of kilowatt hours (“kWh”) used. (Id.).

2. Minimum Distribution System

As noted above, ComEd’s ECOSS departs from an accurate representation of cost causation because it does not include a customer cost component based on the minimum distribution system concept. (Chalfant IIEC Ex. 2.0 at 13:250-256). While this concept has not been adopted by the Commission in the past, it is a concept that is fully recognized by the National Association of

Regulatory Commissioners (“NARUC”). The NARUC manual recognizes that utility Accounts 364-370 have a customer component and recognizes the use of the minimum distribution system (“MDS”) concept. (McClanahan BOMA Ex. 2.0 at 13:280-299; Rubin, Tr. 1052).

The MDS concept recognizes that the cost of the distribution system is customer related as well as demand related. Specifically, the MDS concept recognizes that the cost of the distribution system includes a customer related component that is associated with the need to “cover the system”. (Chalfant IIEC Ex. 2.0 at 13:257-261). The distribution system is designed not only to meet customer demand, but to physically connect each customer’s service facilities to the system, regardless of the size of the customer. (*Id.* at 14:272-276). That is before the distribution system can meet customer demands, the customers must be attached to the system. Therefore, regardless of customer demand, there are some distribution facilities, of a minimum size, that must be used to connect the customer and his service to the system. (*Id.* at 14:274-285).

ComEd has allocated all of Accounts 364-368 to the demand function.⁹ As a result, ComEd’s study may over-allocate distribution costs to the non-residential classes. (*See*, Chalfant IIEC Ex. 2.0 at 15:289-361). Therefore, the cost responsibility of non-residential customers could be overstated under ComEd’s ECOSS. IIEC recommends the Commission direct ComEd to incorporate a MDS concept for Accounts 364-368 in its next ECOSS. In the alternative, the Commission should direct ComEd to make the results of such a study available to the parties in the next delivery service rate case.

⁹ Account 369 has been allocated among the customer classes on a direct assignment basis. (Heintz ComEd Ex. 25.0 at Fn. 1; Rubin, Tr. 1047).

3. Proper Allocation of Distribution Costs

CUB/CCSAO witness Mr. Ruback recommended that 50% of the cost of the distribution system should be allocated on the basis of electric energy (kWh) used by customers. (Ruback CUB/CCSAO Ex. 1.0 at 19:387-388).

ComEd no longer owns electric production facilities. (Clark, Tr. 209). Thus, by definition, production costs are no longer reflected in ComEd's ECOSS. As a result, the CUB/CCSAO witness came to the erroneous conclusion that the elimination of production costs from the ComEd ECOSS necessitates a change in the method for allocating distribution costs. (*See*, Chalfant IIEC Ex. 6.0 at 5:91-93; Ruback CUB/CCSAO Ex. 3.0 at 11:194-196). Mr. Ruback also suggested that it would be "fair" to recognize annual consumption of energy in the allocation of non-customer related (i.e., demand related) distribution costs. (Ruback CUB/CCSAO Ex. 3.0 at 17:331-334). These proposals should be rejected for several reasons.

First, removal of production costs from the ECOSS does not mean that the method for allocation of other costs, such as distribution costs, needs to be altered or modified. Removal of production costs does not change the fact that distribution costs are caused by, and a function of, the number of customers and their demands on the system. In other words, there is no change in the cost causation of the distribution system when production costs are removed from consideration in the ECOSS just as the cost of operating a car is not changed by the fact that the radio is removed from the car. (Chalfant IIEC Ex. 6.0 at 6:102-108).

Second, fairness does not provide a basis for changing the allocation of 100% of distribution costs on the basis of demand and number of customers to allocating 50% of those costs on the basis

of kWh used. While fairness and equity require costs to be allocated to cost causers, it does not require that costs be allocated in accordance with any individual's subjective definition of fairness. (Chalfant IIEC Ex. 6.0 at 6-7:112-117).

Mr. Ruback attempts to illustrate the unfairness of failing to allocate distribution costs on the basis of kWh used by providing an example of two customers with the same demands, but one of which uses three times the kWh of the other. He concludes that a demand-based allocation of distribution costs to these customers would be unfair because both customers would pay the same. (Chalfant IIEC Ex. 6.0 at 7:125-131). However, the fact that one customer may make fuller use of facilities that are designed and installed to serve the same level of demand for electricity does not make it fair to allocate more of the cost of that demand related investment to one customer than another. In fact, the only fair approach would be to allocate the same amount of cost to each customer since the utility incurs no greater cost to serve the first customer than the second. (Chalfant IIEC Ex. 6.0 at 7:122-136).

To allocate distribution costs that are essentially demand or customer related on the basis of kWh consumed, is equivalent to charging one customer more than another customer for the same camera simply because the second customer intends to take more pictures. (Chalfant IIEC Ex. 6.0 at 7-8:132-139).

Mr. Ruback proposed to allocate 50% of ComEd's distribution costs on the basis of kWh consumed. The proposal is arbitrary. It has no factual or logical support in the record other than the witness' subjective opinion of what is fair. (Chalfant IIEC Ex. 6.0 at 8:140-149). The fact of the matter is that even though IIEC witness Chalfant has testified in twenty cases in Illinois, he has

never seen the approach recommended by Mr. Ruback adopted in an Illinois electricity case. Also, based on his extensive experience in other jurisdictions, such proposals are rarely made and when made, have usually been rejected. (Chalfant IIEC Ex. 6.0 at 8-9:150-162).

Such proposals should also be rejected in this case.

G. Revenue Allocation

2. Class Risk Differentials

ComEd proposes that for revenue allocation purposes, each customer class be assigned a share of the ComEd revenue requirement, such that the rate of return for each class would equal the system average rate of return. (Heintz ComEd Ex. 11.2 at 2). CUB/CCSAO witness Mr. Ruback proposes that a target rate of return for the residential class be set at 97.5% of the system average rate of return. He does so on the assumption that residential customers are “less risky to serve” than non-residential customers. (Ruback CUB/CCSAO Ex. 3.0 at 29:601-603). This recommendation is without credible foundation in the record.

Mr. Ruback reasons that such an adjustment is justified because regulatory commissions grant higher rates of return to utilities with more risk and the same principle should be applied to customer classes in this case. That is, customer classes with less class risk should provide lower rates of return than customer classes with greater class risk.

This proposal should be rejected for several reasons. First, Mr. Ruback failed to define the phrase “class risk” or explain why or how it is equivalent to the utility risks that are evaluated by regulatory commissions in establishing a utility’s cost of capital. Nor does he indicate how such risks can be used in evaluating so-called class risk. (Chalfant IIEC Ex. 6.0 at 9:174-177).

Second, Mr. Ruback provided no evidence to rank or quantify any difference in risk among the various classes in this case. (Chalfant IIEC Ex. 6.0 at 10:178-186).

Third, there is no evidence of any link between a ranking or quantification of class risk and the 97.5% multiplier (or any other multiplier) Mr. Ruback developed. (Chalfant IIEC Ex. 6.0 at 10:187-188).

Fourth, the 97.5% multiplier is devoid of any factual basis in the record. (Chalfant IIEC Ex. 6.0 at 10:189-190). Absent such a factual basis, the Commission cannot and should not, adopt such a multiplier.

Fifth, there are facts in the record that suggest smaller customers may, in fact, be riskier to serve than larger customers. The ComEd rate design in this case contemplates that larger customers will pay their bill through a facilities distribution/demand charge and a customer charge. Thus, the revenue they furnish to ComEd will not be subject to changes in temperature or changes in seasons, or reductions in annual usage. On the other hand, bills for residential customers reflect a rate design which collects charges on the basis of the customer's usage. Usage can be dramatically affected by such things as weather. Therefore, ComEd, on the basis of this rate design, may actually face less risk in serving larger customers rather than smaller customers. (Chalfant IIEC Ex. 6.0 at 10:191-201). However, it would be just as inappropriate to reflect this increased risk, in the allocation of revenue responsibility in this case, by adjusting the target rate of return for non-residential customers downward as it is to reflect the alleged lower risk of serving smaller customers by adjusting the target rate of return for residential customers downward.

For all these reasons, the recommendation of Mr. Ruback, to establish a target rate of return multiplier of 97.5% for the residential class, should be rejected.

H. Rate Design

1. Customer Class Delineations

b. Non-Residential

2) Very Large Load Customers

(a) Retention of Separate Class for Over 10 MW Customers

ComEd proposes to combine the four current non-residential rate classes into a single class, the Very Large Load Customer class, consisting of all customers 1 MW and over, other than those customers served at a high voltage level of 69 kV or higher. Customers served at 69kV or higher will be in a separate class. (Crumrine ComEd Ex. 9.0 at 35:Table 4).

IIEC opposes the consolidation of the four current non-residential rate classes (i.e., 1-3 MW customers, 3-6 MW customers, 6-10 MW customers and over 10 MW customers). IIEC recommends the over 10 MW class be retained as a separate class. (Stephens IIEC Ex. 1.0 at 15:289-298). All parties who addressed this issue in their testimony agree that ComEd's proposed combination of the non-residential customer classes should be rejected and a separate rate class of over 10 MW customers retained. (Swan DOE Ex. 1.0 at a0:252-258; *See* McClanahan BOMA Ex. 4.0 at 7:162-164, suggesting that all current non-residential classes be retained; Anosike/Zika CTA Ex. 3.0 at 1-2:27-29;).¹⁰

¹⁰ IIEC notes that parties representing interests of residential consumers also opposed the combination of various residential classes. (*See* AG Ex. 2.0 at 4-5:80-87). Therefore, it appears

ComEd's current delivery rate classes were approved by the Commission in ComEd's first delivery service rate case in Docket No. 99-0117. In that case, ComEd proposed fifteen separate delivery service classes. Nine of those classes were defined in terms of customer load in kW. (Commonwealth Edison Company, ICC Dkt. No. 99-0117, 99 Ill. PUC Lexis 647 at 107). In that case the Commission concluded ComEd had appropriately defined its customer classes in accordance with the applicable provisions of the Public Utilities Act (the "Act"). (Id. at 116). It also noted ComEd's rate classes had been consistently approved and had been shown to be based on customer size, which had a high correlation to the voltage levels at which customers were served. Therefore, ComEd's rate class structure allowed the Commission to take into consideration voltage level differences as required under the Act. (Id. at 116-117). The Commission concluded ComEd's size differentiated rate classes properly assigned costs in compliance with cost causation and were just and reasonable. (Id. at 117).

In Docket No. 01-0423, ComEd's last delivery service case, ComEd retained the rate classes approved in Docket No. 99-0117, maintaining the four-class rate structure for non-residential customers above 1 MW. (Stephens IIEC Ex. 1.0 at 12:215-219). ComEd also proposed, and the Commission approved, a Rider HVDS to apply to customers taking service at high voltage (69 kV and above). The Commission concluded ComEd's rate design in that case was just and reasonable. (Commonwealth Edison Company, Dkt. No. 01-0423, Order, March 28, 2003 at 148-149).

that the only party in this case believes it appropriate to combine ComEd's existing rate classes is ComEd.

ComEd's proposal to combine the four non-residential rate classes into a single rate class would have significant impact on large customers, especially those with demands 10 MW and over. For example, 10 MW and over customers served at standard voltage will see increases in delivery service rates of 133%. Those served at high voltage will see increases of 109%. (Stephens IIEC Ex. 1.0 at 7-8:Tables 1 and 2). Some customers, particularly those 10 MW and over customers served at high voltage, could see increases as high as 160%, when accounting for elimination of Rider 8 credits, if applicable. (Swan DOE Ex. 1.0 at 4-5:86-89).

ComEd's delivery service rates for above 10 MW customers are already much higher than those of any other Illinois utility. If ComEd's requested rate increase is approved by the Commission, ComEd's rates will be dramatically higher than those of other Illinois utilities. (Stephens IIEC Ex. 1.0 at 8-10:159-176).

ComEd's rationale for combining the existing non-residential rate classes has evolved during this case. In ComEd's initial filing in this case, it offered two simple justifications for the combination of these rate classes. First, the charges currently in effect for the rate classes that were to be combined were very similar. This indicated to ComEd that the costs of providing delivery service to those customers were very similar. This similarity did not justify continued maintenance of separate delivery service classes. (Crumrine ComEd Ex. 9.0 at 38:808-813).

Second, some of the granularity in ComEd's current rate structure was primarily the result of competitive transition charges ("CTCs"). Therefore, since CTCs would disappear after December 31, 2006, the current class separations were no longer needed. (Id. at 38:814-816).

IIEC witness Stephens demonstrated that neither of these factors provided sufficient justification for the Company's proposal. The first rationale is simply wrong. Current charges for 10 MW and over customers are approximately one-half of the charges applicable to the three smaller customer classes. Currently the facilities distribution charge, for 10 MW and over customers served at standard voltage, is \$2.34 per kW. The same charge for the other three rate classes assuming service at standard voltages, ranges from a low of \$4.46 per kW to a high of \$4.64 per kW. (Stephens IIEC Ex. 1.0 at 7: Table 1). For 10 MW and over customers served at high voltage, the current facilities distribution charge is \$1.04 per kW, while it ranges from \$3.16 to \$3.34 per kW for the other three rate classes, assuming service at high voltage. (Stephens IIEC Ex. 1.0 at 8:Table 2).

Under ComEd's logic, the fact that charges to over 10 MW customers are significantly less than the charges to the other three subclasses would demonstrate that it is less costly to serve the 10 MW and over class. Thus, combination of the 10 MW and over class with other non-residential classes would not be justified.

Furthermore, IIEC not only demonstrated that the charges for delivery service were not similar for all four of the existing rate classes, it demonstrated that the costs of serving the over 10 MW class were significantly lower than the cost of serving the other three non-residential classes. IIEC witnesses Mr. Stephens and Mr. Chalfant pointed out the Company had failed to perform a cost of service study in its direct case which established the cost of serving the four non-residential classes. (Stephens IIEC Ex. 1.0 at 15:276-279; Chalfant IIEC Ex 2.0 at 9:164-179 and 10-11:197-205).

Given the Company's failure, IIEC witness Mr. Chalfant presented a modified version of ComEd's cost of service study. (Chalfant IIEC Ex. 2.2). The modified study demonstrated that for the main non-residential classes below 10 MW there were very similar demand costs and total costs per kW. However, there was a lower cost per kW for the over 10 MW class. None of the costs developed in the modified study included the high voltage (69 kV and higher) load. Therefore, the lower cost of serving the over 10 MW customers was attributable to customer characteristics other than receipt of service at high voltage. (Chalfant IIEC Ex. 2.0 at 12:234-241).

ComEd's second rationale for combining the rate classes, namely, that granularity in the rate structure was primarily due to the application of CTCs, provides no valid basis for the combination of the existing non-residential classes. As IIEC witness Stephens explained, the 1997 Customer Choice and Rate Relief Law required calculation of individual CTCs for customers larger than 3 MW in ComEd's service territory. However, this fact by itself does not necessarily require ComEd to establish a separate delivery service rate class at 3 MW and over, or at any other level.

ComEd established rate class separations at 1 MW, 3 MW, 6 MW and 10 MW in its initial delivery service case in Docket No. 99-0117, and continued its four class rate structure in its most recent delivery service rate case, Docket No. 01-0423. However, the 3 MW distinction in the calculation of CTCs was no longer applicable at that time, since ComEd had begun to calculate individual CTCs for customers as small as 400 kW in demand. (Stephens IIEC Ex. 1.0 at 12:217-219). Thus, the existence of, and the need to calculate, CTCs could not have provided a basis for ComEd's original establishment or its later continuation of the four non-residential rate classes.

Therefore, elimination of the CTC, as of December 31, 2006, does not provide a valid basis for the combination of these classes as proposed by ComEd.

Mr. Stephens also pointed out that ComEd's proposed Very Large Load Customer Class, consisting of all customers 1 MW and over, was not consistent with the power procurement segments that were approved at ComEd's request, in Commonwealth Edison Company Docket No. 05-0159. The break points for the power procurement segments were 400 kW and 3 MW, not at 1 MW as proposed by ComEd in this case.¹¹ (Stephens IIEC Ex. 1.0 at 13:230-236).

ComEd's rationale for the combination of the four existing non-residential rate classes began to evolve in its rebuttal case. First, it presented a new cost of service study, which purported to show the cost of serving each of the four existing non-residential classes was essentially the same. (Crumrine ComEd Ex.23.0 at 25:524-531). However, this study actually supports the conclusion reached by IIEC witness Chalfant, that the cost of serving the 10 MW and over customer class is lower on a per kW basis (\$5.12 per kW) than the cost of serving the other three non-residential classes. The absolute values of these figures are, of course, not useful for setting ComEd's rates, since they reflect the full ComEd requested increase in this case. (\$6.41 per kW). (Chalfant IIEC Ex. 6.0 at 3:38-57 and 4:Table 1).

ComEd also took the position in its conclusion that the cost of serving the four non-residential classes was similar and was based on the embedded cost of service study performed in the last case. (Crumrine ComEd Ex. 23.0 at 23:491-501). As noted earlier, however, such a

¹¹ It was the consensus of the Post 2006 working group that the classes for bundled and unbundled customers be synchronized. (Stephens IIEC Ex. 5.0 at 14-15:307-334).

comparison is flawed because the high voltage customers were included in the individual non-residential classes in that study, but are in a separate class under ComEd's proposal in this case. In any event, this position ignores the fact that based on evidence in the record in that case, the Commission did not see fit to use that study for intraclass revenue allocation for non-residential customers. (*See*, Commonwealth Edison Company, ICC Dkt. 01-0423, Order, March 28, 2003 at 137). Because the Commission, based on the evidence in the record in Dkt. 01-0423, rejected the use of ComEd's ECOSS for intraclass revenue allocation, it should not be relied upon in this case to establish intraclass cost relationships for the non-residential class.¹²

Finally, ComEd's proposal would reduce the granularity in its rates and, in turn, introduce the potential for intra-class subsidies.

In sum, ComEd has failed to establish that the costs of serving the four existing non-residential classes are, in fact, similar. Indeed, the record shows they are not. ComEd has not offered any other legitimate reason for combining all four of the existing non-residential rate classes into a single rate class. Therefore, a separate rate class for over 10 MW customers should be maintained.

(b) Proposed Rates for 10 MW and Over Class

In setting separate rates for standard voltage customers in the over 10 MW class, the Commission should start with the current (June 2006) rates and increase or decrease applicable charges in proportion to the overall revenue increase or decrease approved in this case. (Stephens

¹² Indeed, ComEd's position in the last case as a "Joint Movant" was that the Commission's decisions on such issues were supported by substantial evidence. (Commonwealth Edison Company, Dkt. 01-0423, Order, March 23, 2003 at 143).

IIEC Ex. 1.0 at 16:301-305). Under this approach, these customers, assuming ComEd's full rate relief, would still see an increase of 24.8%. This is larger than the percentage increase that would be experienced by the other three non-residential classes, which range from 18% to 22%. (Stephens IIEC Ex.1.0 at 7:Table 1).

With regard to the 10 MW and over customers served at 69 kV and over (the high voltage class), the current net charge of \$1.04 per kW (*See* Stephens IIEC Ex. 1.0 at 8:Table 2), should be increased or decreased in proportion to the overall revenue increase or decrease approved in this case. Under this approach, and assuming the Company's full requested revenue increase, these customers will also see a 24.8% increase. This increase is significantly higher than the increases to the remaining 69 kV customers. They would actually see decreases ranging from -31% to a -35%. (Stephens IIEC Ex. 1.0 at 8:Table 2).

3. Environmental Cost Rate Design

The Staff proposed a change in ComEd's rate design to increase usage and demand charges and reduce customer charges that would otherwise result from cost of service determinations. This proposal was based on concerns expressed by Staff witness Mr. Peter Lazare that ComEd's proposed delivery rates did not take into account the environmental costs of producing power. (Lazare Staff Ex. 6.0 at 37-43:908-919).

While IIEC admires Mr. Lazare's intentions, it believes the most efficient pricing mechanism, in a delivery service case, is to price delivery charges on the cost of delivery service. More particularly, customer charges should recover customer related delivery costs and demand charges should recover demand related delivery service costs. (Stephens IIEC Ex. 5.0 at 21: 485-

488). The environmental problems of concern to Mr. Lazare are associated with the production of electric power and energy, not its delivery. (Lazare Staff Ex. 6.0 at 37:910-911; Stephens IIEC Ex. 5.0 at 21:488-489; Crumrine ComEd Ex. 23.0 at 40:861-867). The cost of generating power already reflects the environmental cost of production to the extent society has deemed appropriate. (Stephens IIEC Ex. 5.0 at 21:490-492). Thus, customers, whether they purchase the power through the ComEd auction, or from third-party suppliers, are already paying power costs that include the environmental costs of concern to Mr. Lazare.

Furthermore, Staff did not demonstrate, and indeed could not demonstrate, that the proposed rate design change would have the effect of minimizing any detrimental effects on the environment. This is because the rate design will have marginal impact on customer distribution bills and little impact on the total bill for electric service. In fact, for some customers, the change might actually decrease their overall delivery service charges while increasing charges to other customers. It would be nothing more than speculative to suggest that marginal changes in the distribution portion of the customers bills (increases and decreases) will elicit any meaningful reduction in pollution. (Stephens IIEC Ex. 5.0 at 22:497-503). Therefore, Staff's proposal should be rejected.

4. Rider ECR

ComEd has proposed a new tariff, Rider ECR - Environmental Cost Recovery Adjustment, to recover an uncertain, but broad, range of environmental costs. Under proposed Rider ECR, which would operate independently of ComEd's base rate tariffs, ComEd proposes "to recover all Incremental Costs . . . incurred by the Company in association with Environmental Activities." ComEd identifies two categories of costs for Rider ECR recovery -- manufactured gas plant (MGP)

site costs and non-MGP site costs, including ComEd's Superfund and leaking underground storage tank program costs. (Gorman IIEC Ex. 7.0 at 24:553-556; Hill ComEd Ex. 19, Sch. 18).

In the rider, Environmental Activities are very broadly defined to include any activity related to "environmental contamination." The recoverable Incremental Costs include everything from the costs of inspections by or for ComEd, to certain real estate costs for covered activities, to ComEd's litigation and settlement fees or costs. Moreover, the definitions of these critical terms expressly disclaim any limits suggested by the lengthy lists of covered activities and costs.

The precise scope of those terms, indeed whether they have any bounds at all, remains uncertain.¹³ Indeed, on its face, Rider ECR is broad enough to authorize recovery of nuclear plant clean-up costs at sites formerly owned by ComEd.

In anticipation of Rider ECR's approval, ComEd witness Jerry Hill proposed to remove approximately \$3 million from ComEd's revenue requirement. (Hill ComEd Ex. 5.1, Schedule C-2.3). Acknowledging other parties' opposition to the rider, Mr. Hill later proposed that if the rider is rejected ComEd be permitted to correct his \$3 million revenue requirement reduction by adding approximately \$11.57 million to ComEd's revenue requirement. (Gorman IIEC Ex. 7.0 at 27:632-635).

For economic, legal, and policy reasons, proposed Rider ECR should be rejected. ComEd has offered no evidence that environmental cost recovery through base rates has been inadequate

¹³ Mr. Gorman found the proposed recovery of litigation expenses through an environmental cost recovery rider especially egregious. The rider would destroy ComEd's economic incentive to protect itself (and its customers) from gratuitous litigation and excessive legal costs. Under Rider ECR, ComEd could simply pass through all such fees and costs to its customers.

or problematic in any way. The rider also has legal deficiencies, including the vague overbroad definitions and the absence of any attempt to show that the costs to be recovered are actually related to delivery services. Finally, approval of this rider would represent an unjustified departure from Illinois' traditional regulatory model.

a. *ComEd Has Shown No Economic Justification for Rider ECR*

IIEC witness Gorman recommended that ComEd's proposed Rider ECR be rejected. (Gorman IIEC Ex. 3.0 at 3:60). ComEd has been recovering through base rates the costs it now proposes to recover through a rider. (Gorman IIEC Ex. 3.0 at 51:1139-1141). ComEd has failed to show that the expenses to be recovered by Rider ECR are significant, volatile, and outside of management's control, or would impede the Company's ability to earn its authorized return from regulated utility operations. (Gorman IIEC Ex. 3.0 at 52:1166-1169). A special rider recovery mechanism is not warranted.

ComEd always has successfully recovered its MGP costs (and other environmental costs) through base rates. Indeed, ComEd has consistently rejected the option of seeking rider recovery. (Crumrine ComEd Ex. 9.0 at 24:535-537). (This is despite the alleged volatile, unpredictable nature of the costs.) ComEd has offered no evidence that base rate recovery would not continue to be as effective in the future.

ComEd's posture is essentially that it is entitled to recover through a rider any costs that are volatile, unpredictable and beyond management control. (Crumrine ComEd Ex. 23.0 at 61:1302). However, ComEd has identified no authority that makes approval of a rider mechanism mandatory rather than a matter of Commission judgment. Mr. Gorman examined whether the magnitude of the

costs, their volatility, and the effect of rider recovery on management are reasonable criteria for the Commission to use in exercising its discretion as to such requests. For costs as relatively small as those proposed for recovery by ComEd, the characteristics on which ComEd relies for rider treatment are common to numerous expenses incurred (and managed) by almost any business enterprise.

As to the magnitude of the costs involved, Mr. Gorman observed that a variation in operating expense of \$1.5 to \$2 million -- approximately the size of ComEd's annual non-MGP expenses -- would change ComEd's operating income by approximately \$.9 to \$1.2 million and change ComEd's earned rate of return by only 0.02% (earned ROE by 0.04%), assuming ComEd's proposed capital structure and rate base. (Gorman IIEC Ex. 7.0 at 26:600-605). An expense deviation of about \$4 million -- an approximation of the largest recent variation in ComEd's MGP expenses -- would change its earned rate of return and ROE by 0.4% and 0.7% respectively, using the same assumptions. (Gorman IIEC Ex. 7.0 at 25:582-587). It is reasonable to expect that these costs may be under-recovered in some years and over-recovered in other years, with full recovery likely over time. (Gorman IIEC Ex. 7.0 at 25:582-593, 26:612). In neither case is the variation significant enough to impair ComEd's ability to earn its authorized return. (Gorman IIEC Ex. 7.0 at 25:587-589, 26:605-607).

As to the nature of the costs, consider the comparative of ComEd's storm expenses. ComEd incurs storm related costs that in recent years were as much as \$10 million in capital investment and \$18 million in expenses. Like ComEd's assertions about its environmental costs, storm expenses are expected to occur, but the timing and magnitude of the costs cannot be predicted. (Hill, Tr. 890).

ComEd's storm costs may have greater volatility and been greater in magnitude than its environmental costs. (Gorman IIEC Ex. 7.0 at 25-26:577-606; Hill Tr, 892, 894). Yet, ComEd argues that the nature of its environmental costs require a special rider, while storm costs will be recovered through base rates.

b. *If Rider ECF Is Not Approved, ComEd's \$12 Million Correction for a \$3 Million Adjustment Should Be Rejected*

In conjunction with his recommendation that ComEd's Rider ECR be rejected, Mr. Gorman proposed that if the Commission accepts his recommendation, ComEd be permitted to add back to its cost of service the same \$3 million amount that was removed from the Company's revenue requirement in preparation for recovering these costs through Rider ECR. ComEd, however, proposed that if Rider ECR is rejected, ComEd be permitted to add \$11.577 million of expenses to the Company's cost of service -- not the \$3 million actually removed. (Gorman IIEC Ex. 7.0 at 27:628-635; Hill ComEd Ex. 5.0 at 37:801). Mr. Gorman contested Mr. Hill's proposal, since adding back more expenses than were removed in the first instance would over-recover ComEd's actual environmental expenses.

ComEd offers no plausible justification for its extraordinary proposal. ComEd asserts that in Dkt. 01-0423 the Commission permitted the utility to recover in base rates its full projected annual expenditures even while it uses reserve accounting for those same expenses. (Hill, Tr. 885, 886). That is, ComEd alleges the Commission authorized it to recover more than the amount it was recording as expenses on its books. First, ComEd provides no citation to or quotation of any such language in the Commission's order. Second, when questioned about the apparent over-recovery,

Mr. Hill offered his view that theoretically the numbers would equalize over time. (Hill Tr. 886). However, he was unable to say that ComEd customers (who bear the cost burden) have seen any such result. (Hill, Tr. 887).

ComEd's proposed Rider ECR should be rejected and its environmental expenses recovered through base rates. The utility should be permitted to add back to its revenue requirement only the \$3 million it had removed.

17. Rider RESALE

In its direct testimony, Commonwealth Edison proposed Rider RESALE to replace the current Rider 12 - Conditions of Resale or Distribution of Electricity by the Customer to Third Persons. Building Owners Management Association of Chicago, CES and IIEC voiced a concern that under the proposed language by ComEd, building owners be confused or would not be able to recover all the costs of providing electric service within their buildings to their tenants. (Stephens IIEC Ex. 1.0 at 22:445-450; O'Connor CES Ex. 1.0 at 16:359-363; Brookover & Childress BOMA Ex. 7.0 at 15:323-325).

IIEC's original concern was in reference to the phrase in the proposed language "other adders applicable to the electric power and energy provided to such retail customer." The nature of these adders was not specified in the tariff. The lack of specificity had the potential to either (1) create unnecessary confusion about what can be recovered by the customer providing the electricity, or (2) not allow customers providing electricity to recover legitimate costs associated with resale or redistribution of the power to the end-use customers. IIEC proposed that Rider RESALE be

modified to clarify that all legitimate costs associated with the resale or redistribution of electricity are allowed to be collected by customers.(Stephens IIEC Ex. 1.0 at 24:479-481)

CES and BOMA witnesses raised similar concerns that the language proposed in the Resale Restriction section of ComEd's proposed Rider RESALE could inadvertently be interpreted in a way that would not permit resellers of electricity to fully recover their costs and could limit resellers' ability to charge appropriately for electricity they resell. (O'Connor CES Ex. 1.0 at 16:358-374; Brookover & Childress BOMA Ex. 7.0 at 15:322-331)

After reviewing BOMA, CES and IIEC testimony ComEd agreed the concerns were legitimate. (Alongi & McInerney ComEd Ex. 24.0 at 24:604-628). ComEd believes that the modifications suggested by BOMA witnesses Mr. Childress and Mr. Brookover adequately address all of the concerns raised and has agreed to accept the proposed language if it is approved by the Commission. (Id.) IIEC agrees the language adopted by ComEd in rebuttal adequately addresses the issue.

22. Proposed Change in Definition of Maximum Kilowatts Delivered

ComEd proposes to change the basis for the maximum demand determination for customers in classes that have demand based distribution facilities charges. It specifically proposes that maximum billing demand for such customers be determined using a 24-hour period, not just the peak period as required under existing ComEd tariffs.¹⁴ (Crumrine ComEd Ex. 9.0 at 44-45:959-964). IIEC recommends the current definition or method of determining MKD be retained. (Stephens

¹⁴ Peak period is the period between 9:00 a.m. and 6:00 p.m. Monday through Friday, except on days when certain holidays are observed. (See ComEd Ex. 10.2, 21st Rev. Sheet No. 18).

IIEC Ex. 1.0 at 19:364-367). It is joined in this position by the Commission Staff, the Illinois Association of Wastewater Agencies (“IAWA”), and the Chicago Transit Authority (“CTA”). (Lazare Staff Ex. 17.0 at 37-39:927-962; Menninga IAWA Ex. 1.0 at 9:157-165; Anosike CTA Ex. 1.0 at 5-6:100-111). No party supported ComEd’s proposed change in the definition of, or the method of determining MKD. (Crumrine, Tr. 2271).

The current method of determining MKD on the basis of the on-peak period should be retained for several reasons. First, in the absence of compelling reasons to change the method principles of rate continuity warrant retention of the current method. This method has been in use in ComEd’s tariffs for many years and was retained as part of the tariffs through ComEd’s last two delivery service cases in ComEd Dockets Nos. 99-0117 and 01-0423. Thus, the current definition of MKD is a long-standing feature of ComEd’s bundled service and unbundled delivery service rates. Changing the current definition would not be consistent with the rate design principles of rate continuity and prevention of rate shock. (Stephens IIEC Ex. 9.0 at 4; Stephens IIEC Ex. 8.0 (Public) at 13:270-271).

Second, modification of the definition or method of determining MKD would introduce confusion or increased operating costs for customers who are familiar with the current demand measurement periods used to determine MKD. The existing demand measurement periods have provided price signals to encourage off-peak usage through the establishment of on-peak periods and charges for many years, through many rate cases, including all of ComEd’s delivery service rate cases to date. (Stephens IIEC Ex. 1.0 at 18:355-362).

Third, retention of the current definition of or the method of determining MKD will ensure that those customers who have made investments to enable and facilitate their off-peak operation, to the benefit of the ComEd system in response to ComEd's long-standing rate design will retain the financial benefit associated with those investments. (See Stephens IIEC Ex. 1.0 at 18:359-362).

Fourth, retention of the current definition of MKD is, contrary to ComEd's position, more consistent with the well-established Commission policy of assigning costs to cost causers. The time of day that customers establish their highest demands is a critical factor in the actual facilities cost incurred by the utility. These costs, which are incurred in the provision of delivery service, are driven by the highest total demand on each piece of distribution equipment used to provide the service. (Stephens IIEC Ex. 9.0 at 3). The cost of the portion of the distribution system comprised of facilities dedicated to individual customers are indeed driven by the highest demand of a single customer regardless of when that occurs.¹⁵ However, for facilities used to provide service to multiple customers, the cost of those facilities and thus, the resulting cost of service, is driven by the highest level of the combined demand (i.e., total demand) of those customers served by such facilities. (Stephens IIEC Ex. 9.0 at 3). As IIEC has explained: "[T]his is not the same as the sum of the highest individual demands of all customers served by those facilities, . . ." a concept which ComEd wishes to incorporate into its rates for billing purposes by changing the definition of MKD. (Id.). ComEd's proposal diverges from the principle of cost causation and results in higher costs to

¹⁵ However, ComEd already has a mechanism to recoup some of those dedicated facilities costs, to the extent they are non-standard, through ComEd's current Rider 6 and proposed Rider NS. (Stephens IIEC Ex. 8.0 at 11:228-236).

customers who lower distribution costs for ComEd as well as lowering costs of electricity delivery for all customers. (Id.).

IIEC illustrated these points through an example that assumed a single distribution system with three industrial customers, each customer with a maximum annual demand of 10 MW, and all served by the same facilities. Two of the customers, A & B, are assumed to be one shift operations. Each of them has their highest demand (10 MW) during the on-peak period. Because customers A and B each have a one-shift on-peak operation, their off-peak demands are zero. The third customer, C, is assumed to have a three-shift operation that reaches its highest demand (10 MW) during the nighttime hour, while holding its on-peak demand to 5 MW. (Stephens IIEC Ex. 9.0 at 3).

The utility under this example needed to size its system facilities to serve 25 MW of demand. (10 MW for customer A, 10 MW for customer B, and 5 MW for customer C). If the utility charged for delivery service on the basis of ComEd's new definition of, or method for determining MKD, customers A, B, and C would be billed on the basis of their highest individual demand (10 MW) on the false assumption that the utility had to install facilities to serve 30 MW of demand instead of 25 MW of demand. (Stephens IIEC Ex. 9.0 at 4).

If, on the other hand, customer C changed its operation such that its maximum demand (10 MW) occurred during the peak hours, the utility would actually have to size its facilities to meet a peak demand of 30 MW instead of 25 MW. This would increase the system cost to be recovered from all customers. (Stephens IIEC Ex. 9.0 at 3-4).

While the current definition of, or method of determining MKD is not perfectly matched to cost causation, it is superior to ComEd's proposal. Therefore, it should be retained.

Fifth, the current definition of, and method for determining MKD, recognizes the beneficial impact of off-peak operation by those customers who operate primarily off-peak while using network distribution facilities. (See Stephens IIEC Ex. 8.0 at 3:18-27; 13:272-274). As demonstrated in the example above, load diversity can affect the sizing costs of network facilities for transmission and distribution. Customers agreeing to operate primarily in the off-peak periods by choice or necessity benefit the network by not contributing load to the system during general times of network stress. (Lazare Staff Ex. 23.0 (Corrected) at 2-3:49-55 and 4:83-87). In addition, these customers can favorably impact the commodity portion of the bills for customers who continue to buy power obtained through ComEd's power procurement process. (Stephens IIEC Ex. 8.0 (Public) at 7:139-152). This is because the cost of power in off-peak periods tends to be lower than during on-peak periods and thus shifts in load from on-peak to off-peak periods served to lower the auction based supply costs resulting from ComEd's power procurement method, all other factors being held equal. (Stephens IIEC Ex. 8.0 (Public) at 7:144-147). Retention of the current definition of MKD would maintain these benefits.

(b) ComEd's Alternative Proposal

ComEd proposed, for the first time in its surrebuttal testimony, to limit the increase in the facilities distribution charge for 10 MW and over customers to \$3.86 per kW, assuming its position on the definition of, or method for determining MKD was accepted. (Crumrine ComEd Ex. 40.0 at 7-8:129-156). ComEd suggested there was a relationship between its proposal to limit the facilities distribution charge and its proposal to change the definition of, or method for determining, MKD. (Crumrine ComEd Ex. 40.0 at 8:158-167). Specifically, ComEd suggested that there would

be a perverse incentive for customers to “game the system” if they had the flexibility to adjust their demand between peak and off-peak periods. According to ComEd witness Crumrine, under such circumstance, customers could game the system by changing their consumption patterns to set their demand at 10 MW or more for just a single one-half hour period each year and thereby avoid higher charges associated with the 1 to 2 MW customer classes. (Crumrine ComEd Ex. 40.0 at 8-9:158-178). However, on cross-examination, Mr. Crumrine admitted the alleged gaming situation, which he claimed provided the linkage between ComEd’s proposal to retain a separate class for 10 MW and over customers and its proposal to change the definition of MKD, would exist regardless of whether or not ComEd’s definition of MKD is adopted. (Crumrine, Tr. 2275-2279). Thus, there is no reason to link the two proposals. Further, ComEd did not explain why this alleged gaming opportunity is suddenly a concern now, when the separate 10 MW and over class and current MKD definition have coexisted since delivery service rates first began in 1999.

For all the reasons stated above, ComEd’s current definition of MKD should be retained and its proposal to change the definition should be rejected.

30. Other (Rider ZSS7)

ComEd now has two separate methods for charging customers, who own their own generation or have generation on their premises, for delivery service. One set of customers is charged pursuant to Rider ZSS - Zero Standard Service - and the other is charged for delivery service under Rate RCDS based on the customer’s MKD in any month, as if the customer did not have generation. (Stephens IIEC Ex. 1.0 at 19:372-377). ComEd proposes in this case to replace Rider ZSS with new Rider ZSS7 - Zero Standard Service 2007. If ComEd’s proposal to change the

definition of MKD from an on-peak basis to a 24-hour basis is adopted by the Commission, IIEC recommends that the eligibility provisions of Rider ZSS7, as proposed by ComEd, be modified to make all customers with generation eligible for service under that Rider.

ComEd's proposed change in the definition of MKD can have a disproportionate impact on self-generation or cogeneration customers who require delivery service in any month to deliver power to replace the output of their generating unit. The impact is especially significant for customers who have either planned or unplanned generation outages that are most prevalent during the off-peak periods. (Stephens IIEC Ex. 1.0 at 19:379-384).

While IIEC strongly opposes ComEd's modification to the definition of MKD, if that definition is changed as proposed by ComEd, IIEC's proposal to modify Rider ZSS7 would be to broaden the eligibility criteria to enable self-generation and cogeneration customers to have their cost of delivery service determined more directly (essentially on an individual basis) and billed through the zero standard service approach. (Stephens IIEC Ex. 1.0 at 20:386-294).

Conversely, instead of making Rider ZSS7 available to all customers currently eligible for the Rider, ComEd's new rider will actually be applicable to 28% fewer customers (12 out of 33) than the original Rider ZSS.

In an effort to remedy this situation, IIEC recommends the applicability provisions of current Rider ZSS be incorporated into ComEd's proposed Rider ZSS7, or otherwise modified to broaden, not narrow, eligibility should ComEd's proposed changes to MKD be adopted.

CONCLUSION

For the reasons stated above, IIEC Companies respectfully request that the Commission:

- A. retain a separate rate class for 10 MW and over customers and reject the Company's proposal to combine the 10 MW and over customer class with the other three existing non-residential rate classes above 1 MW;
- B. retain the current definition of, or method of determining, Maximum Kilowatts Delivered (MKD) so that such a determination continues to be based upon the customer's highest demand during on-peak periods;
- C. modify Rider ZSS7 to broaden the applicability provisions to include all customers with generating facilities, if the Commission should approve ComEd's proposed change in the definition of MKD;
- D. direct ComEd to incorporate the minimum distribution system concept into its cost of service study in the next case, or direct ComEd to provide parties to that case with the results of such a study;
- E. continue to allocate the costs of the distribution system on a demand and customer basis and reject proposals to allocate the costs of the system on an energy basis;
- F. reject proposals to allocate revenues on the basis of hypothetical or speculative class risk differentials;
- G. adopt the Staff's recommended ratemaking capital structure of 37.11% common equity and 62.89% debt;
- H. adopt IIEC's recommended rate of return on common equity of 9.9%;
- I. adopt IIEC's recommendation to determine the level of A&G expense to be included in ComEd's rates based on the percentage increase or decrease in O&M expense, other than A&G, ultimately approved in this case;

- J. establish the level of general and intangible plant to be included in ComEd's rates in this case in an amount equal to the percent increase in net distribution plant for ComEd in this case;
- K. reject modifications to ComEd's delivery service rate design to decrease customer charges and increase demand charges to reflect environmental costs of producing power;
- L. reject ComEd's proposal for an environmental cost rider; and
- M. adopt ComEd's Rider RESALE, as modified by ComEd in rebuttal and incorporate language recommended by BOMA.

Respectfully submitted,

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