

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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

IIEC POSITIONS

B. Rate Base

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

IIEC says 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. In this case IIEC recommends the Commission approve a level of G&I Plant equal to the percent increase in the related net distribution plant approved for ComEd. 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.

IIEC argues its 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. According to IIEC these witnesses have testified that much of this type of plant seems to be directly involved in supporting other plant investment. IIEC says 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. IIEC states that 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%. Given the relationship between the level of distribution plant and O&M expenses to the level of G&I Plant, IIEC suggests it is not reasonable that ComEd's G&I Plant would increase by 222.2% over levels approved in the last case.

Second, IIEC argues 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, according to IIEC, 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

IIEC takes the position that 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. Such expenses are sometimes referred to as "overhead." IIEC says 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.

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. It is IIEC's position 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 according to IIEC.

IIEC says its 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. IIEC notes the Commission specifically approved \$176.7 million as the reasonable A&G level for ComEd's 2000 test year. 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. Therefore, IIEC reasons 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. IIEC states 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. IIEC says its proposal maintains the relationship between A&G and O&M, other than A&G, established in the last case.

IIEC next says ComEd did not compare its proposed level of A&G to past levels of A&G and did not compare its proposed level of A&G to the level of O&M it is requesting in this case.

IIEC reasons that ComEd, not intervenors, has the burden to prove the justness and reasonableness of its rates. 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, IIEC concludes that 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. IIEC says 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

IIEC notes ComEd has proposed a capital structure made up of 54.2% common equity and 45.8% debt to develop its overall cost of capital. IIEC witness Gorman opposed that capital structure as too heavily weighted with equity, which is more costly for ratepayers. Mr. Gorman concluded that ComEd did not fully remove the common equity supporting goodwill from its proposed ratemaking capital structure. 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. He recommended adoption of Staff's capital structure -- 37.11% equity and 62.89% debt. That structure is the result of including only equity that actually supports assets used

in providing ComEd's delivery services. Staff's proposed capital structure should, therefore, be used to develop ComEd's overall rate of return for its delivery services.

IIEC states both it and Staff pursued a common objective of developing a capital structure for ComEd that reflected the amount of common equity and debt that now support ComEd's transmission and distribution utility assets. However, Staff and IIEC support that common capital structure with distinct, independent (yet complementary) analyses.

It is IIEC's view, the Commission should not give excessive weight to technical accounting mechanics to determine the equity component of the proper capital structure. IIEC says the Commission should not lose sight of the core issue: What is a reasonable capital structure that reflects the investment actually supporting ComEd's delivery services assets and operations?

IIEC witness Mr. Gorman's approach to this question, which is distinct from the accounting exercise advocated by ComEd, 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. 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.

IIEC argues ComEd's balance sheet has over \$11 billion in total capital. Its test year rate base is \$6 billion. Between the rate base and total capital IIEC reasons that ComEd does not need \$11 billion of capital to finance a \$6 billion rate base. The major difference between ComEd's rate base and total capital is 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. Thus, IIEC argues good

will is not a transmission distribution asset, it's financed solely with common equity. Therefore, it's appropriate to carve that common equity out of capital structure and attribute it only to the good will asset. This leaves approximately 6 to \$7 billion in capital to finance a \$6 billion rate base. IIEC says this is typical of what one normally sees from ComEd's capital structure in reviewing the utilities actual capital structure and rates. Total capital and rate case don't always match, but they are generally pretty close. So, it is appropriate under the circumstances IIEC says to remove the common equity supporting the good will asset .

IIEC supports Staff's argument that the effects of ComEd's goodwill asset should be removed from the capital structure. IIEC says ComEd's goodwill asset is not a transmission or distribution asset. And, it is not used in providing ComEd's delivery services. IIEC notes ComEd has excluded it from its proposed rate base in this case. 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." According to IIEC, the equity supporting ComEd's goodwill should be excluded from the capital structure used to determine ComEd's delivery services revenue requirement.

IIEC says that since the objective in this proceeding is to measure ComEd's cost of providing regulated utility service, it's appropriate to look at ComEd's total capital and identify what part of that capital represents its cost of funding utility plant investments. IIEC reasons the capital structure proposed by Staff witness Ms. Kight and supported by IIEC is the proper assessment of that capital supporting regulated utility rate base and therefore should be adopted.

3. Cost of Common Equity

IIEC argues ComEd overestimated its required return on common equity when it requested an authorized equity return of 11%. IIEC, through its witness Mr. Gorman, recommended a return on common equity (“ROE”) of 9.9%, which Mr. Gorman found adequate to support ComEd’s credit rating and its financial integrity.

IIEC’s recommendation was 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”). IIEC’s recommendation is based on these results of Mr. Gorman’s models: DCF (9.7%); RP (10.2%); and CAPM (10.2). According to IIEC these three analytical models, each of which was used by at least one other ROE witness in this case, have been employed regularly in Illinois regulatory proceedings.

IIEC notes ComEd’s witness Dr. Samuel Hadaway, also conducted multiple studies, but IIEC says virtually every cost estimate made by Dr. Hadaway was overstated and flawed. However, its witness 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.

IIEC argues 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 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.

IIEC says the primary disputed DCF model input in this case is the growth rate. To estimate "G" (the expected constant growth in dividends), IIEC witness Gorman used the consensus estimate of investment analysts of the expected growth rate. 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%.

IIEC opines that 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. However, Mr. Gorman explained that security analysts' growth estimates have been shown to be more accurate predictors of future returns than growth rates derived from historical data and are the most likely growth estimates that are built into stock prices.

Mr. Gorman's consensus analysts' growth rates (4.67% and 4.42%) for the proxy groups he and ComEd used were 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 exceeding the growth rate for the economy. Therefore, growth rates for the economy in the utility's service territory are a good proxy for a sustainable long term growth rate for earnings.

IIEC says Mr. Gorman used a conservatively high growth estimate, based on virtually every logical and verifiable assessment of long-term sustainable DCF growth. He describes the input as conservative because historically these utilities' dividend growth have not exceeded the rate of inflation, projected growth but his analysis approaches two times the projected rate of inflation of 2.5%. IIEC says Mr. Gorman was conservatively high because historically, utility earnings and dividends have grown at a rate much slower than GDP growth.

IIEC says Mr. Gorman's conservative growth variables reflect the conditions most likely to prevail while the rates determined in this case will be in effect. It reasons that 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.

On the other hand, IIEC says, ComEd's proposed analysis uses historical data that unreasonably denies its customers any benefit of today's (and likely tomorrow's) reality. IIEC says the Commission should accept Mr. Gorman's analysis estimating ComEd's required return on common equity.

IIEC also points out its witness used a risk premium model in estimating ComEd's required return on equity. 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 says its witness, 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.

IIEC says 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 relied entirely on projections according to IIEC. IIEC says ComEd's reliance on projections is misplaced because the accuracy of projected interest rates is highly problematic. In addition, IIEC says Dr. Hadaway increased 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 has been shown to be questionable by academic studies. IIEC also states Mr. Gorman relied on actual observable bond yields, while Dr. Hadaway's RP study used his own idiosyncratic projection of bond yields. IIEC argues Mr. Gorman's RP analysis is more reasonable and merits the Commission's reliance.

IIEC states Mr. Gorman's use of a combination of projected and current, observable interest rates was carefully considered and fully justified. It says 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. While 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, because projected changes to interest rates are highly uncertain and the accuracy is at best problematic. Mr. Gorman chose to be conservative in his analysis by considering both current and projected interest rates, thus reflecting a range of possible interest rates during the period rates set in this proceeding are in effect.

IIEC says considerable protection against increasing costs of capital is inherent in a utility's right to initiate ratemaking proceedings. This provides an effective hedge against increasing costs and is additional reason why there was no need to inject uncertain capital costs into rates. IIEC argues the Commission can be confident that ComEd will act if actual interest rates diverge significantly from current projections. Accordingly, IIEC says Mr. Gorman's RP model, which recognized the reality of today's economic conditions and today's investor's expectations should be accepted as the superior analysis by the Commission.

IIEC says its witness Mr. Gorman also performed a CAPM analysis, which is a specialized form of risk premium analysis. Mr. Gorman developed a CAPM analysis as well as DCF and bond yield RP analyses. According to IIEC, Mr. Gorman's CAPM results varied only modestly from his other models; in fact, his CAPM and RP results were identical.

IIEC opines that 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. Accordingly, IIEC says the debate on CAPM issues has focused on other witnesses' application of this model.

4. Overall Cost of Capital

IIEC states that the overall cost of capital recommendation ties together the determinations of recommended ROE, cost of debt, and capital structure. From the 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%. IIEC says its testimony demonstrates that the cost of equity analysis presented by ComEd's witnesses (when corrected for specific errors in the DCF and RP analysis) supports a recommended ROE in the range of 9.8% to 10.4%, consistent with IIEC's recommended ROE of 9.9%. IIEC 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 showed that with IIEC's recommended 9.9% ROE and the Staff's capital structure ComEd would be able to maintain its current investment grade bond rating (BBB+) and also have an opportunity to achieve its target bond rating of A.

IIEC says 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.

Its 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, IIEC's recommended rate of return

on common equity and the Staff capital structure, and the 6.5% embedded cost of debt, produce financial ratios that will support ComEd's current BBB+ bond rating and provide ComEd with the opportunity to achieve its target A bond rating.

F. Cost of Service Issues

1. Embedded Cost of Service Study

IIEC notes ComEd recommended the use of an embedded cost of service study ("ECOSS") in this proceeding for rate design and revenue allocation purposes. However, the study presented by ComEd did not provide information on the cost to serve the existing non-residential customer classes and it did not adopt the concept of the minimum distribution system.

Because the Company's ECOSS did not provide information on the cost of serving the existing non-residential classes, IIEC argues 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 therefore recommends be retained as discussed in Section III.H.1.b.2).(a) below. IIEC reasons that because the Company's ECOSS does not reflect the minimum distribution concept, the study overallocates the cost to the Very Large Load Class. 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, IIEC recommends the Commission should reject proposals to arbitrarily allocate 50% of the cost of the distribution system on the basis of kilowatt hours ("kWh") used.

2. Minimum Distribution System

It is IIEC's position that 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. While IIEC recognizes this concept has not been adopted by the Commission in the past, IIEC says it is a concept that is fully recognized by the National Association of Regulatory Commissioners ("NARUC"). IIEC points out the NARUC manual recognizes that utility Accounts 364-370 have a customer component and recognizes the use of the minimum distribution system ("MDS") concept.

IIEC suggests 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". IIEC says 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. 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.

IIEC notes ComEd has allocated all of Accounts 364-368 to the demand function and as a result, ComEd's study may over-allocate distribution costs to the non-residential classes. Therefore, it is IIEC's position the cost responsibility of non-residential customers could be overstated under ComEd's ECOSS. Therefore, IIEC recommends the Commission direct ComEd to incorporate a MDS concept for Accounts 364-368 in its next ECOSS. In the alternative, IIEC requests the

Commission direct ComEd to make the results of such a study available to the parties in the next delivery service rate case.

3. Proper Allocation of Distribution Costs

IIEC says 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.

In response IIEC points out ComEd no longer owns electric production facilities. Thus, by definition, it reasons production costs are no longer reflected in ComEd's ECOSS. As a result, it would be erroneous to conclude, as the CUB/CCSAO witness did, that the elimination of production costs from the ComEd ECOSS necessitates a change in the method for allocating distribution costs. Mr. Ruback, the CUB/CCSAO witness 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. IIEC says 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, IIEC says 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.

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.

IIEC says 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. IIEC says Mr. Ruback concluded that a demand-based allocation of distribution costs to these customers would be unfair because both customers would pay the same. However, IIEC reasons 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, it says 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.

IIEC argues that 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.

Mr. Ruback's proposal is arbitrary according to IIEC. It has no factual or logical support in the record other than the witness' subjective opinion of what is fair. IIEC witness Chalfant who has testified in twenty cases in Illinois, has never seen the approach recommended by Mr. Ruback adopted in an Illinois electricity case. Also, based on his extensive experience in other jurisdictions Mr. Chalfant testified such proposals are rarely made and when made, have usually been rejected. IIEC says such proposals should also be rejected in this case.

G. Revenue Allocation

2. Class Risk Differentials

IIEC points out that 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. It also notes 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, because residential customers are allegedly “less risky to serve” than non-residential customers and have less “class risk”. IIEC says this recommendation is without credible foundation in the record and should be rejected for several reasons.

First, IIEC says 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 did he indicate how such risks can be used in evaluating so-called class risk.

Second, according to IIEC, Mr. Ruback provided no evidence for the record to rank or quantify any difference in risk among the various classes in this case. .

Third, there is no evidence in the record of any link between a ranking or quantification of class risk and the 97.5% multiplier (or any other multiplier) Mr. Ruback developed.

Fourth, the 97.5% multiplier is devoid of any factual basis in the record. Absent such a factual basis, IIEC says the Commission cannot and should not, adopt such a multiplier.

Fifth, IIEC reasons there are facts in the record that suggest smaller customers may, in fact, be riskier to serve than larger customers. IIEC says 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. However, IIEC says it would be just as inappropriate to reflect this increased risk of serving smaller customers, in the allocation of revenue responsibility in this case, as it would be to reflect the alleged lower risk of serving smaller customers in such revenue allocation.

Therefore, IIEC says the recommendation 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

IIEC recommends retention of a separate class for 10 MW and over customers. IIEC notes that 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.

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. IIEC points out that all parties who addressed this issue in their testimony agreed 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.

IIEC says 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 the Commission concluded ComEd had appropriately defined its customer classes in accordance with the applicable provisions of the Public Utilities Act (the "Act"). The Commission concluded ComEd's size differentiated rate classes properly assigned costs in compliance with cost causation and were just and reasonable.

IIEC also points out that in Docket No. 01-0423, ComEd's last delivery service case, ComEd retained the rate classes approved in Docket No. 99-0117. IIEC says the Commission concluded ComEd's rate design in that case was just and reasonable.

IIEC argues 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, depending on the voltage level at which they are served, will see increases in delivery service rates of 133% to 109%. Some customers, particularly those 10 MW and over customers served at high voltage, could see increases as high as 160%.

IIEC notes ComEd's delivery service rates for above 10 MW customers are already much higher than those of any other Illinois utility and will be dramatically higher than those of other Illinois utilities if ComEd's rate increase is approved.

IIEC says that 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. Second, some of the granularity in ComEd's current rate structure was primarily the result of competitive transition charges ("CTCs") and therefore, since CTCs would disappear after December 31, 2006, the current class separations were no longer needed.

IIEC says that neither of these factors provided sufficient justification for the Company's proposal. The first rationale is simply wrong according to IIEC. 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. 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.

According to IIEC, 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.

IIEC presented a modified version of ComEd's cost of service study. 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. In addition, IIEC points out the cost of service study ComEd presented in rebuttal testimony supports IIEC's conclusion that the cost of serving 10 MW and over customers are not similar to the cost of service the smaller non-residential classes. Studies presented by ComEd in its last delivery service case do not support ComEd's proposal to combine the four non-residential rate classes either.

IIEC says those studies included 69 kV customers in each of the separate classes and the Commission rejected the use of the ComEd study in the last case for intraclass revenue allocations.

IIEC says 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. 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, according to IIEC, 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.

IIEC points out 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. 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, IIEC concludes 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.

IIEC also argues 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.

In sum, IIEC says ComEd has failed to establish that the costs of serving the four existing non-residential classes are, in fact, similar, the record shows they are not, and 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, IIEC recommends a separate rate class for over 10 MW customers should be maintained.

IIEC also recommends that 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. IIEC says under this approach, these customers, assuming ComEd's full rate relief would still see an increase of 25.7%, which is larger than the percentage increase that would be experienced by the other three non-residential classes, which range from 18% to 22%.

With regard to the 10 MW and over customers served at 69 kV and over (the high voltage class), IIEC recommends the current net charge of \$1.04 per kW, 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, IIEC says these customers will also see a 25.7% increase. This increase is significantly higher, according to IIEC, than the increases to the remaining 69 kV customers, who would actually see decreases ranging from -31% to a -35%.

3. Environmental Cost Rate Design

IIEC objects to Staff's proposal to change ComEd's rate design to increase usage and demand charges and reduce customer charges to account for environmental cost of producing power. 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, IIEC says customer charges should recover customer related delivery costs and demand charges should recover demand related delivery service costs. IIEC points out the environmental problems of concern to Mr. Lazare are associated with the production of electric power and energy, not its delivery. The cost of generating power already reflects the environmental cost of production to the extent society has deemed appropriate according to IIEC. Thus, IIEC says 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 Staff.

IIEC also says Staff's proposed rate design has not been proven and cannot be proven to 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. IIEC says the change might actually decrease the overall delivery service charges for some customers while increasing charges to others. Therefore, 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. Thus, IIEC recommends Staff's proposal be rejected.

4. Rider ECR

IIEC recommends Rider ECR as proposed by ComEd be rejected. ComEd proposes to recover all incremental costs incurred by the Company in association with Environmental Activities under the Rider. ComEd identifies two categories of cost recovery -- manufactured gas plant (MGP) site costs and non-MGP site costs, including ComEd's Superfund and leaking underground storage tank program costs.

IIEC says ComEd has shown no economic justification for Rider ECR. ComEd, according to IIEC, has been recovering through base rates the costs it now proposes to recover through a rider. ComEd has consistently rejected the option of seeking rider recovery. (This despite the alleged volatile, unpredictable nature of the costs.) 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. As a result IIEC argues a special rider recovery mechanism is not warranted.

IIEC presented evidence regarding 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

\$0.9 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. 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. 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. In neither case is the variation significant enough to impair ComEd's ability to earn its authorized return.

IIEC reasons that the environmental costs are similar in their unpredictable nature to storm costs, yet ComEd does not have a rider recovery mechanism for storm costs. Finally, IIEC points out that the Commission has the discretion to deny the use of a rider in this case and it should exercise its discretion to reject Rider ECR in his case.

IIEC argues that if the Commission accepts its recommendation, ComEd should 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. IIEC points out that ComEd suggested it should be permitted to add \$11.577 million of expenses to the Company's cost of service -- not the \$3 million actually removed. However, adding back more expenses than were actually removed in the first instance would over-recover ComEd's actual environmental expenses.

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

17. Rider RESALE

IIEC states its original concern was with ComEd's Rider RESALE 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.

IIEC says 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 a customer redistributing electricity to fully recover their costs.

IIEC notes that after reviewing BOMA, CES and IIEC testimony, ComEd agreed the concerns were legitimate. ComEd adopted modifications suggested by BOMA witnesses Mr. Childress and Mr. Brookover which it believed adequately addressed all of the concerns raised and agreed to accept the proposed language if it is approved by the Commission. IIEC agrees the language adopted by ComEd in rebuttal adequately addresses the issues it raised as a concern.

22. Proposed Change in Definition of Maximum Kilowatts Delivered

IIEC recommends the current definition or method of determining MKD be retained. It says it is joined in this position by the Commission Staff, the Illinois Association of Wastewater Agencies

(“IAWA”), and the Chicago Transit Authority (“CTA”). It points out no party supported ComEd’s proposed change in the definition of, or the method of determining MKD, a fact it says ComEd has acknowledged.

IIEC argues that in the absence of compelling reasons to change the method, principles of rate continuity warrant retention of the current method. It points out 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 according to IIEC. Therefore, IIEC says changing the current definition would not be consistent with the rate design principles of rate continuity and prevention of rate shock.

IIEC also argues that 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.

IIEC says 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.

IIEC also says retention of the current definition of MKD, contrary to ComEd's position, is more consistent with the well-established Commission policy of assigning costs to cost causers. IIEC says the time of day that customers establish their highest demands is a critical factor in the actual facilities cost incurred by the utility. These delivery service costs are driven by the highest total demand on each piece of distribution equipment used to provide the service. 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. 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 according to IIEC. IIEC 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. ComEd's proposal diverges from the principle of cost causation and results in higher costs to customers who lower distribution costs for ComEd as well as lowering costs of electricity delivery for all customers. While the current definition of, or method of determining MKD is not perfectly matched to cost causation according to IIEC, it is superior to ComEd's proposal. Therefore, it should be retained.

Finally, IIEC argues 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. 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. In addition, IIEC says 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. IIEC reasons 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. IIEC says retention of the current definition of MKD would maintain these benefits.

IIEC notes ComEd proposed, 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. ComEd says there is a relationship between its proposal to limit the facilities distribution charge and its proposal to change the definition of, or method for determining, MKD. ComEd claims this linkage is based on a hypothetical gaming opportunity that would somehow be created in the absence of the link. IIEC says there is no gaming opportunity created if the facilities charge is lowered and the current MKD definition is retained. There is no relationship between the facilities distribution charge and MKD that increases the possibility of the hypothetical gaming. IIEC argues the hypothetical "gaming" situation, ComEd alleges would exist if the lower facilities charge and MKD are not linked, would exist regardless of whether or not ComEd's definition of MKD is adopted. IIEC says that using ComEd's flawed logic, the alleged gaming opportunity is actually easier under ComEd's proposed 24 hour MKD definition, as the artificial expansion of load would be cheaper if it occurs during the

off-peak period. Thus, there is no reason to link the two proposals. Furthermore, IIEC says 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 it identified, IIEC recommends ComEd's current definition of MKD be retained and ComEd's proposal to change the definition should be rejected.

30. Other (Rider ZSS7)

IIEC recommends 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, 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.

IIEC says 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.

While IIEC strongly opposes ComEd's modification to the definition of MKD, it suggests that if the 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.

IIEC says that 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.

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Respectfully submitted,

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