STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	)	
	)	
	)	**Docket No. 05-0597**
Proposed general increase in rates for delivery service	)	
	)	

SUMMARY OF POSITIONS OF THE

STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned counsel, pursuant to the ruling of the Administrative Law Judges ("ALJs") at the October 20, 2005, status hearing (Tr., pp. 21-24, 27-28), respectfully submits this summary of positions advocated by or on behalf of the Staff witnesses for inclusion in the proposed order to be issued by the ALJs. Staff's summaries are submitted based on the following understandings and reservations of rights:

1. Staff's summaries were not drafted to include additional responsive arguments that will be included in Staff's reply brief to be filed on May 11, 2006. Staff assumes that the ALJs will be adding reply brief positions to the summaries of parties' positions included in the proposed order.

2. Staff's summaries do not include each and every fact, point or argument contained in the testimony of the Staff witnesses or Staff's Initial Brief. Rather, Staff's summaries were intended to present the essential elements of Staff's positions and are not a substitute for Staff's testimony or Staff's Initial Brief. The omission of a specific

fact, opinion, or argument in the summaries does not indicate that Staff has in any way withdrawn, changed or abandoned such assertions or arguments.

3. Staff's summaries are presented under the outline headings adopted by the ALJs for purposes of the briefs. To the extent that the proposed order utilizes a revised or modified outline, the summaries should be moved accordingly.

II. STATEMENT OF UNCONTESTED ISSUES

A. Issues That No Party Contests

2. Elements of Rate Base

a. 21 Capital Project Additions

Staff's Position

Staff does not oppose ComEd's proposed rate base additions associated with twenty-one capital projects. ComEd witness David G. DeCampli, in his direct testimony (*see generally*, ComEd Ex. 4.0) proposes rate base additions associated with twenty-one major capital projects listed in ComEd Ex. 4.3. To evaluate the rate base additions related to these projects, Staff witness Linkenback reviewed a representative cross section of both distribution plant and general and intangible plant projects. Based on that review, Staff witness Linkenback does not oppose ComEd's proposed rate base additions. (ICC Staff Exhibit 8.0, pp. 2-6)

b. Staff Adjustment Related to ComEd Schedule B-2.1

Staff's Position

Staff witness Thomas L. Griffin proposed an adjustment to ComEd's plant balance. Mr. Griffin determined that a correction to the plant balance was necessary so that there was agreement with ComEd's workpapers supporting ComEd's Schedule B-2.1 and ComEd workpapers WPB2.1a and WPB2.1b. (ICC Staff Exhibit 3.0 Corrected, p. 5) Mr. Griffin's adjustment reduces Plant in Service by $2,063,000; increases Accumulated Depreciation by $25,000; increases Accumulated Deferred Income Tax by $13,000 and decreases Depreciation Expense by $51,000. (ICC Staff Exhibit 3.0 Corrected, Schedule 3.4, page 1 of 2 and ICC Staff Exhibit 14.0 Corrected, Schedule 14.2, page 1 of 2). No party contested Mr. Griffin's adjustments.

c. Pro Forma Capital Additions and Construction Work In Progress

Staff's Position

Staff witness Thomas L. Griffin proposed an adjustment to eliminate $53,449,000 from ComEd's proposed pro forma Capital Additions along with the related adjustments to Accumulated Depreciation, Accumulated Deferred Income Taxes and Depreciation Expense because it represented projects that were in rate base twice. (ICC Staff Exhibit 3.0, Schedule 3.3) Mr. Griffin testified that the projects were included in both pro forma Capital Additions and Construction Work in Progress (CWIP). Mr. Griffin came to an agreement with CUB/CCSAO Witness Mr. McGarry and ComEd Witness Jerome Hill that a proper level of CWIP for the purposes of this case is 70% of the CWIP balance at December 31, 2005 or $41,047,000. Therefore, the parties agreed that CWIP should be reduced by $12,402,000 and that Mr. Griffin's adjustments to pro forma Capital Additions are no longer necessary. (ComEd Ex. 45.0, Tr., p. 2388)

3. Elements of Operating Expenses

a. Advertising Expense Adjustment

Staff's Position

Staff witness Dianna Hathhorn proposed an adjustment to decrease the Company's operating expenses to disallow promotional and goodwill advertising costs. (ICC Staff Exhibit 1.0, Schedule 1.10) ComEd did not contest this adjustment in its rebuttal testimony. (ComEd Ex. 19.0, p. 58)

b. Staff 2005 Wage and Salary Adjustment

Staff's Position

In direct testimony, Staff witness Ebrey proposed an adjustment to correct an error in the Company's pro forma adjustment for 2005 wages and salaries. (ICC Staff Exhibit 2.0, p. 30)

c. Post-Retirement Healthcare Benefits

Staff's Position

In rebuttal testimony, Staff witness Ebrey testified that she was not contesting ComEd's change to its post-retirement healthcare expense based upon an actuarial study from the summer of 2005, which was included in the Company's December 14, 2005 errata filing. (ICC Staff Exhibit 13.0, p. 2)

4. Elements of Rate Design and Tariffs

a. Rider PM

Staff's Position

Staff does not oppose Rider PM as proposed by ComEd. Rider PM – Primary Metering Adjustment is a new rider proposed by ComEd. Through this rider, ComEd proposes to adjust the rate for retail customers who receive electric service at or above 2,160 volts. Each thirty minute measurement made by the meter-related facilities, for the qualifying customers, is reduced by 0.8%. (Sched. E2, Ill. C.C. No. 2, Sht. 457) Retail rates take into account electrical losses associated with providing electricity to a customer's premises, although there are differing amounts of loss associated with different voltages. The reduction for retail customers who receive electric service at or above 2,160 volts takes into account electrical losses based on average load conditions for transformers typically used to provide electrical service to customers eligible for primary metering. The percentage adjustment amount was determined by calculating the average electrical losses based on average load conditions for transformers purchased by ComEd that are typically used to provide standard service to retail customers. (ComEd Ex. 10.0, p. 32; ComEd Exhibit 10.19 – Primary Metering Adjustment Determination) Staff witness Linkenback reviewed the accuracy of the distribution transformer loss value employed in the proposed Rider PM. Staff finds that the assumptions and calculations made by ComEd reasonably support the meter adjustment; therefore, Staff does not oppose the proposed Rider PM. (ICC Staff Exhibit 8.0, pp. 16-17)

b. Rate MSPS7

Staff's Position

Staff does not oppose the proposed Rate MSPS7 – Meter Service Provider 2007. Rate MSPS7 replaces the existing Rate MSPS – Meter Service Provider. Staff witness Linkenback reviewed the supporting documentation in ComEd Exhibits 10.27, 10.28 and 10.29. Staff finds that the supporting documentation and responses to Staff data requests sufficiently address Staff's inquiry into this rate. (ICC Staff Exhibit 8.0, pp. 18-19)

5. Other

a. Original Cost Audit

Staff's Position

On March 22, 2006 Staff filed a Motion for Entry of Interim Order Directing Performance of Original Cost Audit ("Motion"). Staff and ComEd agreed that in an effort to eliminate issues and to serve the interests of administrative efficiency for the parties and the Commission, they were willing to not offer into evidence testimony relating to the original cost audit. Staff and ComEd instead agreed that Staff would request and ComEd would not oppose a Commission order requiring an audit. (Motion, pp. 2-3)

No party opposed Staff's Motion. On March 23rd the ALJs granted Staff's Motion. On April 5, 2006 the Commission entered an interim order directing that an audit of the scope and manner as set forth in the prefatory section of the Interim Order be performed. (Docket No. 05-0597, Interim Order Dated April 5, 2006, p. 5) Given all of the above, the original cost audit is no longer at issue in this proceeding.

b. Exelon GSA-Reporting Requirements

Staff's Position

Staff witness Hathhorn testified that various reporting requirements were necessary for ComEd in light of the passage of the Energy Policy Act of 2005. (ICC Staff Exhibit 1.0, pp. 13-14 and ICC Staff Exhibit 12.0, pp. 12-13) Staff and ComEd reached a compromise concerning Staff's original recommendations. (Tr., p. 1712) The agreement reached between Staff and ComEd is as follows:

As an attachment to its ILCC Form 21, ComEd will report ComEd's and BSC's (Exelon Business Services Company) total corporate governance charges by functional area, in the same format as was attached to its SEC Form U-13-60. This requirement will not expire.

ComEd also agreed to provide the following requested schedules as attachments to its Form 21 for items greater than $100,000 in that year:

- Outside Services Employed-Account 923
- Employee Pensions and Benefits-Account 926;
- General Advertising Expenses-Account 930.1;
- Rents-Account 931;
- Taxes Other Than Income Taxes-Account 408;

- Donations-Account 426.1; and

- Other Deductions-Account 426.5.

This requirement also will not expire.

On the same date it is filed with the Federal Energy Regulatory Commission ("FERC"), ComEd will provide a complete copy of its FERC Form 60 to the Manager of the Commission's Accounting Department.

Finally, ComEd agreed that within 30 days of implementation, ComEd will notify the ICC Manager of Accounting of any substantial changes in its allocation factors. A change is defined by 1) a change in the allocation basis for a function or 2) a change in the calculation of a factor. A substantial change is defined as a change in an allocation factor that would result in an increase or decrease in total BSC costs allocated to ComEd by more than 5%, or $10 million, whichever is greater, relative to the prior calendar year.

All of the above agreements should be ordered by the Commission in this docket.

B. Proposals To Which Certain Parties Have Agreed

1. Elimination of Rate 87

<u>Staff's Position</u>

Staff does not oppose the elimination of Rider 87, provided that ComEd gives notice of termination of the contract to the customers in the City of Rockford in compliance with the rate-sheet. (ICC Staff Exhibit 18.0, p. 4)

4. Other

a. Rider ZSS7

<u>Staff's Position</u>

Staff does not object to ComEd's proposed Rider ZSS7 -- Zero Standard Service 2007, which would replace existing Rider ZSS -- Zero Standard Service. (ICC Staff Exhibit 7.0, p. 10) Rider ZSS7 provides a credit to customers who do not use ComEd's distribution facilities. The credit compensates customers for charges they pay to ComEd for ComEd facilities they do not use. Customers who take from this rider are required to have direct access to PJM markets (i.e., the regional transmission organization that provides wholesale electricity to ComEd's territory).

b. Rate BES-L

Staff's Position

Staff does not object to ComEd's proposed Rate BES-L ("Basic Electric Service-Lighting"), which would replace two existing special service contracts (*i.e.*, contract with Chicago Park District and City of Chicago) covering service for street lighting. (ICC Staff Exhibit 7.0, p. 10) In 2007, ComEd will begin acquiring energy from third party providers. It is Staff's view that ComEd need not offer special service contracts to selected customers, because the remaining customers would be subsidizing the rates the special service customers pay. Rate BES-L ties the costs of serving the Chicago Park District and City of Chicago to ComEd's delivery services and to its costs under the procurement process. (*Id.*, p. 11) Tying the costs of service to the costs of procurement resolves Staff's concern regarding subsidization through special services contracts.

III. ARGUMENT ON CONTESTED ISSUES

A. Total Revenue Requirement and Base Rate Revenue Increase

Staff's Position

As reflected on Schedule 1, line 5, column (i) of Appendix A to Staff's Initial Brief, Staff recommends revenues of $1,598,847,000. This is a reduction to ComEd's pro forma present revenues, $1,626,288,000 in Schedule 1, line 5, column (d), Appendix A, of $27,441,000. This revenue decrease is calculated at line 26, column (i) of Schedule 1.

Staff's revenue requirement is calculated by including Staff witness Lazare's adjustment to Administrative and General ("A&G") expense at Column (w), line 11 of Schedule 2 of Appendix A, page 3 of 4. Mr. Lazare's adjustment, though, has been reduced to avoid double-counting an overlapping effect to A&G expense from adjustments presented by Staff witnesses Ebrey, Hathhorn, and certain Intervenor adjustments.

B. Rate Base

2. General Plant - Functionalization and Amount

<u>Staff's Position</u>

Staff recommends ComEd's General & Intangible ("G&I") plant for the 2004 test year be reduced by $304 million. ComEd should not be allowed to place 2000 test year G&I plant that was excluded by the Commission in ComEd's last delivery service rate case (Docket No. 01-0423) back into rate base for the 2004 test year.

ComEd's proposed increase in G&I plant is clearly unreasonable and unjustified. (ICC Staff Exhibit 6.0 Corrected, p. 3) Their proposal should be rejected because (1) it is an attempt to allocate costs to distribution that the Commission previously allocated to generation, (2) the overall increase in G&I plant is unexplained, and (3) all things held constant, divestiture of generation plant, by itself, should not increase costs of G&I plant to delivery services.

ComEd proposes to more than double the level of G&I plant over the currently approved level. The Company's proposes G&I plant of $1,079,579,000 ($840,736,000 in General plant and $238,843,000 in Intangible plant). This represents an increase of $632,988,000 (or 142%) from the $446,591,000 of G&I plant approved in the previous delivery services tariff case, Docket No. 01-0423 (*Commonwealth Edison Company, Petition for approval of delivery services tariffs and tariff revisions and of residential delivery services implementation plan and for approval of certain other amendments and additions to its rates, terms and conditions*, Ill. C.C. Docket No. 01-0423, Final Order, Appendix A, Schedule 3 (March, 28, 2003) ("01-0423 Order")). (ICC Staff Exhibit 6.0 Corrected, p. 5, lines 95-99) More than half of the proposed increase to G&I plant, $405 million of the approximately $633 million increase, results from the Company's proposal to restore G&I plant to the distribution rate base that the Commission removed in Docket No. 01-0423. (ICC Staff Exhibit 6.0 Corrected, p. 12) In Docket No. 01-0423, the Commission significantly reduced ComEd's proposed level of G&I plant supporting delivery services based on its determination of the appropriate allocation of G&I plant between production, transmission and distribution. (*01-0423 Order*, p. 41)

Staff argues that the G&I Plant allocated to generation in Docket No. 01-0423 should not be reallocated to distribution. because it is an attempt to allocate to delivery services rate base the very same costs that the Commission allocated to the generation function in Docket No. 01-0423 when ComEd still owned generation. (*See 01-0423 Order*, p. 37-38, 41) The allocation approach ComEd proposed in Docket No. 01-0423 is the same that it is proposing in this proceeding. (*See 01-0423 Order*, p. 34; ComEd Ex. 5.0 Corrected, p. 18) In Docket No. 01-0423, ComEd proposed to directly assign G&I plant costs when possible, and to use a general labor allocator when costs cannot be specifically attributed to an Illinois-jurisdictional service. In Docket No. 01-0423 the Commission rejected ComEd's proposal in favor of the general labor allocator. Applying the general labor allocator reduced gross plant by $405,160,914. (*01-0423 Order*, p. 37) ComEd acknowledged in response to Staff data request PL 1.15 that $405 million of its increase in G&I is attributed to what the Commission removed in Docket No. 01-0423. (ICC Staff Exhibit 17.0 Corrected, p. 9)

Staff's proposed adjustment is based on the Company's lack of legitimate support for changing the Commission's decision to exclude certain G&I plant from ComEd's delivery service rate case. However, ComEd's attempt to reallocate $405 million into rate base that the Commission had assigned to production in Docket No. 01-0423 not only nullifies the Commission decision in Docket No. 01-0423, it runs counter to the Commission's continuing efforts to ensure that the production function receive a reasonable allocation of G&I plant. (ICC Staff Exhibit 6.0 Corrected, p. 13; *99-0117 Order*, p. 12; *99-0129 / 99-0134 Order* (Illinois Power), p. 30 (Aug. 25, 1999); *99-0121 Order* (AmerenCIPS and AmerenUE), p. 21 (Aug. 25, 1999))

In effect, ComEd's proposal is nothing more than a collateral attack of the Commission's decision in Docket No. 01-0423. While ComEd's proposal is a subtle form of collateral attack, collateral attacks are impermissible and ComEd's proposal must be viewed in this light. Illinois courts have held that a party to a pending action cannot initiate a new proceeding seeking relief that is or could have been the subject of another pending proceeding. (*East Side Levee and Sanitary District v. Madison County Levee and Sanitary District*, 54 Ill. 2d 442, 445, 298 N.E.2d 177, 179 (1973); *Illini Coach Co. v. Illinois Commerce Commission*, 408 Ill. 104, 110, 113 (1951)). If ComEd thought that excluding the $405 million was a decision in docket No. 01-0423 that it should challenge, the matter could and should have been appealed at that point pursuant to 220 ILCS 5/10-113 and 5/10-201 prescribe the procedure. The G&I plant costs established in the last rate case were approved by the Commission because they were found to be "just and reasonable" for setting rates. ComEd cannot simply undo the Commission's decision in the last rate case. ComEd has the burden of presenting evidence showing that the increase in G&I costs are attributed to actual costs, and it has not done so.

Staff also asserts that there is a lack of evidentiary support for increasing G&I plant by 142%. ComEd seeks to more than double the amount of G&I plant costs and neither Mr. Hill nor any other ComEd witness explain why such a significant increase (142%) is needed over the level accepted by the Commission in ComEd's last DST rate case, Docket No. 01-0423. (ICC Staff Exhibit 6.0 Corrected, p. 5, 109-113)

Staff also argues that ComEd's divestiture of generation plant, by itself, should not increase costs of G&I plant. ComEd witness Hill states that the Company divested its generation units on January 1, 2001 and therefore since 2000 has "… no production plant, and, other than its purchased power expense, no significant production operation and maintenance expenses, and no significant labor assigned to production cost… ." (ComEd Ex. 19.0 Revised, p. 17) Thus, because ComEd has no production plant as of December 31, 2004, Mr. Hill contends that "no rationale can be made that any of ComEd's General Plant and Intangible Plant included in its 2004 test year delivery services rate base support a production functional component". (ComEd Ex. 19.0 Revised, p. 22) In addition, ComEd witness Costello states that ". . . ComEd's expenditures and books do not include any costs that can be attributed to the

Production function." (ComEd Ex. 13.0, p. 27) Staff's position is that these claims are simply not true. As stated above, $405 million of the costs ComEd proposes to functionalize to distribution were found by the Commission in Docket No. 01-0423 to be production-related. (ICC Staff Exhibit 17.0 Corrected, p. 13, lines 316-320)

In effect, ComEd's proposal would penalize ratepayers for ComEd's decision to divest generation in 2001. As ComEd acknowledged under cross, it made a business decision to divest generation (Tr., p. 262, lines 13-14). Furthermore, ComEd witness Hill acknowledged under cross examination that rates should not go up solely because of divestiture. (Tr., p. 921, lines 7-19)

Through its proposal, Staff avers that ComEd is in effect asking delivery service ratepayers -- who received no direct benefit from ComEd's decision to divest -- to pay a heavy price for that decision. If, as Mr. Hill agrees, divestiture should not change the underlying cost relationships, then the conclusions of the Commission concerning 2000 test year G&I plant (*01-0423 Order*, p. 41), when ComEd owned production plant, are as meaningful and relevant today as they were in that case.

Staff points out the fact that the production plant ComEd owned up until 2001 has not vanished, it has simply been shifted to an unregulated affiliate. The fact that production plant is now deregulated does not necessarily change the cost relationship with G&I plant. The production affiliate still requires expenditures on G&I plant just as when it was part of the regulated utility, and as discussed above, the Commission determined that level in Docket No. 01-0423. Thus, ComEd should not be allowed to roll that $405 million of G&I plant back into the distribution company's rate base.

Staff's proposal is the more reasonable than ComEd's proposal. Staff currently proposes that G&I plant be reduced by $304 million. Staff's proposed adjustment reverses the decision by ComEd to restore the G&I plant that existed in 2000 but was allocated to production by the Commission in Docket No. 01-0423. (*01-0423 Order*, pp. 37-38, 41) Staff's adjustment would align the current delivery service tariff rate case with the decision handed down by the Commission in Docket No. 01-0423, by not allowing introduction of that same G&I plant into ComEd's delivery services rate base.

Staff's proposed adjustment pertains only to the 2000 test year G&I plant the Commission excluded from rate base in Docket No. 01-0423. Staff has not extended its analysis to plant additions for 2001 and beyond to determine whether they are consistent with the *01-0423 Order*. (ICC Staff Exhibit 17.0 Corrected, p. 14)

The basis for Staff's proposed adjustment of G&I plant comes from ComEd. In discovery, ComEd indicated that the Commission's decision in Docket No. 01-0423 "reduced ComEd's proposed test year jurisdictional general and intangible gross plant by $405 million". ComEd then went on to note that, "[T]herefore, all other things equal, ComEd's starting point (that is, the 2000 test year used in Docket 01-0423) results in a $405 million increase." (ICC Staff Exhibit 17.0 Corrected, pp. 8-9)

Staff, however, amends its original $405 million adjustment to $304 million, in response to a valid issue raised by ComEd witness Hill concerning the calculation of Staff's proposed $405 million adjustment. Mr. Hill argues that the amount is overstated because it fails to properly account for General plant retirements between 2000 and the 2004 test year. He indicates that approximately 25% of 2000 test year General plant was retired before the end of the 2004 test year, and these retirements are not reflected in the proposed $405 million adjustment. (ComEd Ex. 19.0 Revised, pp. 20-21) Staff found this argument to be reasonable. Consequently, the original $405 million adjustment in gross plant has been reduced by approximately 25% to $304 million. (ICC Staff Exhibit 17.0 Corrected, p. 14)

One final point needs to be made. In responding to Staff's proposal, Company witness Hill demonstrates a fundamental misunderstanding of Staff's proposal. He suggests that Staff has introduced a labor allocator in this proceeding as a foundation for functionalizing G&I plant. (ComEd Ex. 29.0, p. 13) That is not the case. Staff has **not** introduced a new allocator for G&I Plant. Rather, Staff simply seeks to be consistent with and maintain the Commission's decision in Docket No. 01-0423 with respect to current G&I plant that existed at that time. It is true that in Docket 01-0423 the Commission applied a general labor allocator to G&I plant. The application of the general labor allocator in that case resulted in the removal of $405 million from distribution rate base and allocated it to production. (ICC Staff Exhibit 17.0 Corrected, pp. 2-3) Staff's adjustment seeks to prevent ComEd from undermining that decision by restoring to the rate base for delivery services the G&I plant that the Commission had excluded in Docket No. 01-0423.

3. Intangible Plant - Functionalization and Amount

<u>Staff's Position</u>

Staff's position regarding Intangible Plant is set forth in Section III.B.2 regarding General Plant.

4. Pension Asset

<u>Staff's Position</u>

Staff witness Ms. Ebrey recommended that the Company's pro forma adjustment to include a "pension asset" in its proposed rate base be reversed. (ICC Staff Exhibit 2.0, pp. 3-13) Staff presented three main bases for its proposed reversal of ComEd's adjustment. (*Id.*, pp. 6-7)

First, Ms Ebrey explained that the pension contribution allocated to ComEd should not be considered separately from the offsetting pension liability attributed to ComEd that gave rise to the contribution. (*Id.*, p. 7) She noted that as defined by the Statement of Financial Accounting Standards No. 87, a pension asset is recognized if net periodic pension cost is less than amounts the employer has contributed to the plan.

(*Id.*, p. 4) Ms. Ebrey testified that when the pension liability and the pension asset are taken together, no pension asset exists because the Accumulated Pension Obligation is offset by the pension asset. As a result, the pension plan is fully-funded and not over funded. (*Id.*) Further, Ms. Ebrey testified that although Exelon Corporation stated that the pension plan is fully funded, leaving neither a pension asset not liability on its books, that fact has not been reconciled to the decision to only reflect an asset on ComEd's books without the offsetting liability. (ICC Staff Exhibit 13.0, p. 6)

Ms Ebrey also testified that the Company's reporting to the Securities and Exchange Commission (such as in Form 10-Q) does not support the existence of this pension asset on a consolidated basis. (ICC Staff Exhibit 2.0, pp. 6-8) Ms Ebrey testified that the absence of a pension asset on Exelon Corporation's March 31, 2005 Form 10-Q consolidated balance sheet indicates that the pension assets for ComEd, PECO, and Exelon Generation were eliminated through the consolidation process as intercompany transactions. (*Id.*, p. 6)

Second, Ms. Ebrey testified that the "pension asset" adjustment should be reversed because the pension trust to which the contribution was made does not represent funds within the Company's disposition. (ICC Staff Exhibit 2.0, p. 9) She stated that ComEd should not be able to earn a return on something in which it has no interest. (*Id.*)

Third, Ms. Ebrey testified that the "pension asset" should be reversed because the discretionary nature of the timing of the pension contribution does not support including some portion of that asset in ComEd's rate base. (ICC Staff Exhibit 2.0, pp. 9-12; ICC Staff Exhibit 13.0, pp. 8-9) She noted that at no point does ComEd claim that the funding made in 2005 was pursuant to a legal requirement of the plan or that was necessary for it to be able to provide safe and reliable service to its customers. (ICC Staff Exhibit 2.0, p. 11; ICC Staff Exhibit 13.0, p. 8) Further, Ms. Ebrey stated that ComEd's proposed ratemaking treatment of its discretionary contribution is detrimental to its ratepayers because it increases the revenue requirement by $27.9 million annually. (ICC Staff Exhibit 13.0, pp. 9-10) She testified that the only impact on the revenue requirement, absent the contribution, would have been an increase to pension expense of $8.6 million rather than the adjustments proposed by the Company which increase the revenue requirement by a total of $27.9 million. (ICC Staff Exhibit 13.0, p. 10)

Staff also noted that the Company will recover the costs associated with its pension plan under Staff's proposal; namely, it will recover the periodic costs of the pension plan as determined by the Company's actuary through pension expense included in the revenue requirement. (ICC Staff Exhibit 2.0, pp. 13-14; ICC Staff Exhibit 13.0, pp. 4, 12)

Staff also disputes the Company's testimony suggesting that if recovery of pension assets in rates is disallowed, the Commission would in effect no longer support direct benefit pension plans for utility workers. (Staff IB, p. 22) Citing Docket 04-0779, Staff noted that the Commission has previously denied requests to include pension assets in rate base where such requests have been found to be improper. (*Id.*) Thus, Staff submits that ComEd's attempt to portray this issue as some sort of Commission referendum on support for direct benefit pension plans for utility workers is baseless, and that any attempt to cast this issue in broader terms amounts to a red herring that is neither supported by the facts nor relevant. (*Id.*)

Further, in its Initial Brief, Staff argued that Company's claim that employees consider ComEd's complete compensation package when deciding whether to work for or continue to work for ComEd must be rejected. (Staff Initial Brief, pp. 22-23) Staff noted Company witness Mitchell was unable to support that statement with actual numbers of employees who had left ComEd due to the status of the pension plan and was unable to quantify the number of potential employees who had turned down a job offer due to the funding status of the pension plan. (*Id.*)

5. Accumulated Deferred Income Taxes

Staff's Position

As noted above, Staff witness Ebrey testified that the Company's pro forma adjustment to include a "pension asset" in its proposed rate base should be reversed. (ICC Staff Exhibit 2.0, pp. 3-13) Ms. Ebrey explained that her "pension asset" adjustment requires a decrease to Accumulated Deferred Income Taxes ("ADIT"). (ICC Staff Exhibit 2.0, pp. 12-13) See Section III.B.4 for a discussion of Staff's Position with respect to the Company's proposed pension asset.

6. Customer Deposits

Staff's Position

Staff witness Ebrey proposed an adjustment to the Company's rate base to reflect the December 31, 2004 balance of customer deposits. Ms Ebrey testified that customer deposits should be used to decrease rate base for ratemaking purposes because customer deposits represent funds provided by ratepayers rather than shareholders and thus, represent a cost-free source of capital for the Company. (ICC Staff Exhibit 2.0, p. 27)

In response to ComEd's rebuttal testimony, Ms. Ebrey testified that, in her experience analyzing cash working capital as a component of rate base, the most frequently used basis for the derivation of a Cash Working Capital requirement, especially for the larger utilities, is a lead/lag study. (ICC Staff Exhibit 13.0, p. 26) She noted that she has never seen a utility include customer deposits as a source of funds in a lead/lag study. (*Id.*) However, recognizing ComEd's obligation to pay interest on customer deposits, Ms. Ebrey did include interest on customer deposits in the Company's operating expenses. (*Id.*)

7. Budget Payment Plan

<u>Staff's Position</u>

Staff witness Ebrey proposed an adjustment to ComEd's rate base to reflect the 13-month average balance of budget payment plan balances ("BPPB") based upon the most recent 13-month period provided. Ms Ebrey testified that a 13-month average is a more representative method for the determination of BPPB than a single point in time due to the volatility and seasonality of the BPPB. (ICC Staff Exhibit 2.0, p. 28) She noted that ComEd did not reflect BPPB as a reduction to its jurisdictional rate base in this proceeding since it is not requesting a component for cash working capital (Company Schedule B-14). (*Id.*) Ms Ebrey stated that had the Company chosen to request an allowance for cash working capital in its test year rate base, the impact for BPPB would have been a reduction to that allowance. (*Id.*) She further testified that for the last 2 years of data provided, the Company has over collected from its budget plan customers for their electric service and has had use of those excess funds. (*Id.*) She testified that the BPPB represent funds provided by the ratepayers rather than shareholders and thus should decrease the balance on which the Company may earn a return. (*Id.*)

In her rebuttal testimony, Ms. Ebrey explained that the Commission has viewed the Customer Deposits (See Section III.B.6.) and BPPB as completely separate issues from cash working capital in recent rate cases. (ICC Staff Exhibit 13.0, p. 27) She observed that in most cases, the Commission has approved the reduction of rate base for Customer Deposits as a separate item from the Cash Working Capital allowance in rate base. (*Id.*) Ms. Ebrey noted that the treatment requested by the Company in this case as well as the treatment of Customer Deposits and Budget Payment Plan balances in ComEd's last delivery services case are the only exceptions to the Commission's long-standing practice. Ms. Ebrey concluded that since ComEd has not provided support for the Commission to change from this long-standing practice, Staff's adjustments for Customer Deposits and Budget Payment Plan Balances should be approved. (*Id.*)

In addition to the foregoing, in its Initial Brief, Staff argued that ComEd's attempt to draw a comparison between the cash provided by ratepayers through BPPB and cash provided by shareholders to offset ComEd's needs to obtain capital from some other source (i.e. funding of the pension plan) should be rejected. (Staff IB, p. 29) Staff noted that the relevant distinction is that the BPPBs represent an overpayment of amounts owed to the Company by its ratepayers, whereas the shareholder-provided funds used to fully-fund the pension plan do not represent an overpayment by the shareholders.

8. Materials and Supplies Inventory

Staff's Position

Staff witness Ebrey proposed an adjustment to decrease the Company's test year materials and supplies inventory balance based on an average of the most recent thirteen months of balances provided by the Company. Ms. Ebrey testified that a thirteen month average is more representative of the balance over time than the year-end balance proposed by the Company due to the volatility of the materials and supplies inventory balances. (ICC Staff Exhibit 2.0, pp. 28-29)

In rebuttal testimony, Ms. Ebrey explained that the facts contradict ComEd's argument that the year-end balance better reflects its current inventory management policies and practices and that the year-end balance is representative of balances throughout the year. (ICC Staff Exhibit 13.0, p. 28) Ms. Ebrey noted that ComEd's monthly data illustrates the volatility on a month to month basis of the materials and supplies balances over the 4 years of monthly data provided by the Company. (*Id.*) Therefore, Ms. Ebrey concluded that the use of a 13-month average is appropriate. (*Id.*) In response to ComEd's rebuttal testimony, Ms. Ebrey revised the accounts payable portion of her adjustment so that it is based upon the average for the test year rather than a 4-year average. (*Id.*, pp. 28-29)

9. Procurement Case Expenses [Rate Base Effect]

Staff's Position

See discussion of Procurement Case Expenses [Rate Base Effect] at Section III.B.10.

10. Rate Case Expenses [Rate Base Effect]

Staff's Position

Staff witness Dianna Hathhorn testified that an adjustment was necessary to disallow the Company's request to include its unamortized balance of rate case expense of $3,693,000 in rate base, in order to insure that there is a fair and equitable allocation of rate case costs between ratepayers and shareholders. Ms. Hathhorn's adjustment also disallows $626,000 in rate case expense amounts estimated by ComEd but unsubstantiated. (ICC Staff Exhibit 1.0, Schedule 1.12 and ICC Staff Exhibit 12.0, Schedule 12.12)

Ms. Hathhorn stated that her proposed treatment of rate case expense requires shareholders to bear the capital costs associated with improving their investment through increased rates, while ratepayers bear the average annual cost for the continued provision of safe reliable service. Without this treatment, she testified that there is little to no incentive for the Company to keep its rate case expenses to a minimum. (ICC Staff Exhibit 1.0, p. 22)

Further, Staff witness Hathhorn noted that in recent ICC orders for unamortized rate case treatment where it was a contested issue before the Commission, only one case, ICC Docket No. 99-0117[1], resulted in the inclusion of the unamortized balance of rate case expense in rate base being approved by the Commission. In that case, she explained that ComEd successfully argued that the proceeding was markedly dissimilar from general rate case dockets in that the proceeding was initiated by law and not by a utility's request for a rate increase. (Docket No. 99-0117, Order dated August 25, 1999, p. 49) However, Ms. Hathhorn testified that this rate case proceeding was initiated by a utility's request for a rate increase and not by law. Therefore, Staff recommended that the Commission follow its customary practice of allowing amortization of rate case expense but not allowing a return on the unamortized balance. (ICC Staff Exhibit 1.0, pp. 22-23)

In responding to ComEd's contention that "the only improvement that the shareholders receive [from a rate case] is the re-setting of fair and reasonable returns on their investment" (ComEd Ex. 19.0 Revised, p. 30), Staff witness Hathhorn noted that in Docket Nos. 94-0065 and 91-0317, the Commission found that Staff's adjustment to recognize the benefits to shareholders resulting from ComEd's rate case process was appropriate. (Docket No. 94-0065, Order dated January 9, 1995, pp. 99-98) (Consumers Illinois Water Company, Docket No. 91-0317, Order dated May 28, 1992, p. 23) (ICC Staff Exhibit 12.0, pp. 21-22)

Further, Staff noted in its Initial Brief that CUB-CCSAO-City of Chicago witness McGarry supported Staff's adjustments to disallow unamortized balances in rate base. (CUB-CCSAO-City of Chicago Exhibit 5.0, p. 32)

In summary, Ms. Hathhorn testified that her position is based on the premise that the benefits shareholders receive from a rate case are the increased rates. The rates do carry risk of over-charging ratepayers for the costs of the rate case incurred to achieve the increased rates, yet ComEd expects ratepayers to bear this risk, while requiring no such symmetry from shareholders. Ms. Hathhorn's position that expects the shareholders to share in that risk is reasonable and reflects a common practice of this Commission. (ICC Staff Exhibit 12.0, pp. 20-21)

Staff witness Hathhorn testified that for the same reasons, the unamortized balance of procurement case expenses should be disallowed in rate base. (ICC Staff Exhibit 12.0, pp. 20-22)

[1] Order entered August 25, 1999.

C. Operating Expenses

2. Pension and Other Post-Retirement Expenses

Staff's Position

Staff witness Ebrey proposed an adjustment to update the Company's pension expense based upon the most recent Towers Perrin[2] actuarial report for the 2004 test year. Ms. Ebrey noted that it has been the Commission's practice to use the actuarially-determined pension expense even in cases where a pension asset is at issue. (ICC Staff Exhibit 2.0, pp. 13-14) Ms. Ebrey testified that her position is consistent with cases in which a pension asset has been at issue, citing two prior Commission Dockets which treated pension expense as a separate issue from the recovery of a pension asset in rate base. (ICC Staff Exhibit 2.0, p. 14)

In her rebuttal testimony, Ms. Ebrey observed that ComEd reflected the same adjustment she proposes in its December, 14, 2005 errata filing. (ICC Staff Exhibit 13.0, p. 12) Ms Ebrey also responded to ComEd's arguments that the actuarially-determined pension expense should be increased if the funding of the "pension asset" is not added to the Company's rate base. She noted that the Company's argument would tie the pension expense to the ratemaking treatment of the Company's discretionary funding of the pension fund rather than the pension expense as determined by the actuary. (*Id.*, pp. 11-12)

3. Administrative & General Expenses

b. Overall Amount

Staff's Position

Staff recommends that the overall amount of Administrative and General ("A&G") not be adjusted from the last delivery services rate case. Adoption of Staff's recommendation would result in a $97.3 million decrease to the revenue requirement ComEd proposes in this docket. (ICC Staff Exhibit 6.0 Corrected, p. 33) Staff contends that ComEd's has not justified its requested increase.

ComEd provides five reasons why it's proposed A&G expenses are reasonable: (1) A&G costs have gone down; (2) functional structure; (3) general inflation; (4) general wage increases; and (5) pro forma adjustments. (ComEd Ex. 19.0 Revised, p. 38) ComEd's discussion of A&G expenses fails to get to the question at hand, which is what is the basis for seeking such a large increase in this category of costs.

[2] Towers Perrin is the consulting firm which provided the actuarial analysis for Exelon's pension plan. Mr. Richard Meisheid, managing principal in Towers Perrin's Compensation practice also provided testimony in this proceeding (ComEd Exhibits 12.0 and 26.0).

(1) Staff Response to ComEd's Proposal

ComEd witness Hill argues that ComEd's proposed A&G expenses are reasonable because they are actually $123 million lower than total Company A&G expenses for the year 2000. Staff points out that Mr. Hill's comparison is flawed. A&G expenses in 2000 included generation, whereas today ComEd no longer has generation. Therefore, the 2000 amount Hill relies upon is inflated and is akin to comparing apples to oranges.

Since ComEd only owns transmission and distribution, the more insightful comparison is the change in the level of A&G expenses for delivery services. Based on that comparison, ComEd's proposed increase is quite significant -- 55% over the level approved for the 2000 test year. It should be noted that the 2000 test year figure was based upon a functionalization methodology proposed by ComEd, rather than Staff or other intervenors. (ICC Staff Exhibit 17.0 Corrected, pp. 15-16)

ComEd claims that its' 2004 A&G costs have increased 9.4% since 2000, and that this percentage is well below other electric utilities. (ComEd Ex. 19.0 Revised, p. 39) This comparison is flawed on two counts. First, stating that it's A&G expenses have increased 9.4% since 2000 is of no weight when its overall proposal is 55% greater than the total delivery services A&G expenses the Commission approved for the 2000 test year. The comparative figures for other utilities are irrelevant as well. Regardless of where ComEd stands relative to other utilities, the fact remains that it has failed to present any justification for its proposed increase in A&G expenses in this proceeding.

Staff finds ComEd's rationale related to general inflation and pro forma adjustments to be equally non-plus. Staff explains that these arguments are simply 'make weight', and that the reality of the numbers presented by ComEd is that it is proposing a 55% increase over the level of A&G expenses the Commission found just and reasonable in Docket No. 01-0423.

ComEd witness Hill argues that A&G expenses must increase to accommodate general wage increases, which he claims to average approximately 3% per year since 2000, and that Staff's recommendation to 'freeze' the level of A&G expenses "… would deny all salaries and wage increases for the ComEd labor within the amount approved in Docket No. 01-0423." (ComEd Ex. 19.0 Revised, p. 42) Staff points out that while ComEd may be paying its employees higher wages since 2000, its overall payroll costs have been decreasing since 2000 -- according to FERC Form 1 data. The overall payroll costs in FERC Form 1 include direct distribution payroll, customer accounts and customer service payroll and A&G payroll. Direct distribution payroll declined from $189,664,419 in 2000 (2000 FERC Form 1, p. 354) to $118,128,755 in 2004 (2004 FERC Form 1, p. 354). Customer Accounts and Customer Service payroll costs also declined over that same period, from $89,914,798 and $4,513,156 in 2000 (2000 FERC Form 1, p. 354) to $77,745,065 and $1,888,017 in 2004 (2004 FERC Form 1, p. 354). Even A&G payroll costs declined by more than half between 2001 and 2004. (2001

FERC Form 1, p. 354, 2004 FERC Form 1, p. 354). Thus, ComEd has realized savings in overall labor costs, even with wages increasing between 2000 and 2004.

Staff even relies on ComEd witness Landon's economies of scale argument:

> Centralized provision of administrative services is an area that generally can be the source of large economies of scale and scope. I have seen no evidence that that is not the case here. Customers should pay their share of the costs that are incurred to serve them and from which they benefit.

(ComEd Ex. 15.0, p. 12) Staff argues that ComEd witness Landon is referring to an opportunity by which ComEd should be realizing savings due to economies of scale, and that these savings should place downward pressure on A&G expenses.

(2) Staff's Proposed Adjustment

Staff proposes that A&G expenses be set at $176,684,000. This results in a $97.3 million downward adjustment to ComEd's proposed revenue requirement. (ICC Staff Exhibit 6.0 Corrected, p. 33) In support of its position, Staff states that this is a healthy increase, of approximately 50%, over what was approved the last time a general labor allocator was used to set A&G expenses (*01-0423 Interim Order)*. Second, and as discussed above, ComEd has not demonstrated that it warrants a greater increase. Third, Staff's proposed increase is a better proposal than ComEd's increase, because ComEd's A&G expenses are 132% above what was approved in the *01-0423 Interim Order*. Fourth, increasing A&G costs is contradictory to the trend of declining direct expenses. Fifth, there is unnecessary uncertainty in ComEd's A&G expenses because costs caused by Exelon Business Services Company ("BSC") cannot be reasonably reviewed or evaluated.

(a) Staff's Level of A&G Expenses

Staff's contends that its proposed level of A&G expense is still significantly higher than levels approved by the Commission in other cases in which it approved of a general labor allocator. The Commission last adopted a proposed general labor allocator for A&G expense in its *01-0423 Interim Order*. The level of A&G expenses approved in that order was $118,153,000. (*01-0423 Interim Order*, Appendix A, Schedule 1) Staff compares its proposed A&G expenses in this docket to the A&G level approved in *01-0423 Interim Order* because ComEd is using a general labor allocator in this docket, similar to what the Commission approved in the *01-0423 Interim Order*. In contrast, the *01-0423 Order* used direct assignment. Thus, Staff's proposal in this proceeding represents an increase of almost 50% over that figure.

(b) Trends in A&G Expenses

ComEd's proposal amounts to an upward spiral in A&G expenses. The use, in the last rate case, of a direct assignment methodology rather than a general labor allocator methodology, dramatically increased ComEd's A&G expenses and set the table for the dramatic increase of 55% requested in this proceeding.

In ComEd's first DST rate case (Docket No. 99-0117), the Commission approved a total of $124,456,000 in A&G expenses based on the general labor allocator. (*Final Order*, Docket No. 99-0117, Appendix A, Schedule 1 (Aug. 26, 1999)) In ComEd's second delivery service rate case, Docket No. 01-0423, the Commission again adopted the general labor allocator for its Interim Order (dated April 1, 2002) and the result was a reduction in A&G expenses to $118,153,000. (*01-0423 Interim Order*, Appendix A, Schedule 1). When the Final Order in Docket No. 01-0423 accepted ComEd's direct assignment approach, the level of A&G expenses climbed sharply to $176,684,000. (*01-0423 Order*, Appendix A, Schedule 1). This represented an increase of $57,806,000 or 48.6% over the level approved in the *01-0423 Interim Order*. (ICC Staff Exhibit 6.0 Corrected, pp. 24-25)

In this proceeding, ComEd is using that as a staring point in an attempt to claim that its request in this case is reasonable. ComEd proposes A&G expenses for the 2004 test year of $274,013,000. (ComEd Ex. 5.0, Schedule A-5, p. 3 of 4). This represents an increase of $97,329,000, or 55.1%, over the level approved in the March 28, 2003 Order and $155,860,000, or 131.9% over the corresponding level set in the *01-0423 Interim Order*. (ICC Staff Exhibit 6.0 Corrected, p. 25)

(c) ComEd's A&G Expenses are Increasing When Its Direct Expenses Are Decreasing

ComEd's increase in A&G expenses is unjustified because it is clearly out of line with what is happening with other costs of ComEd. While ComEd's proposed A&G expenses are spiraling upwards, its proposed changes in direct expenses are declining. ComEd is proposing an increase of $97,329,000 in A&G expenses, while it is proposing a net reduction of $46,033,000 in the total of Distribution, Customer Accounts and Customer Service and Information expenses from the levels approved in the *01-0423 Order* . These figures would suggest that direct and indirect expenses are headed in opposite directions. (ICC Staff Exhibit 6.0 Corrected, p. 26) Staff finds this relevant because the Company itself proposes that A&G expenses be functionalized on the basis of a labor allocator in this proceeding (albeit a narrow allocator limited to transmission and distribution only). Staff further contends that the fact that proposed A&G expenses are bucking the trend of declining direct costs suggests that the success ComEd is realizing in controlling direct expenses is not carrying over to A&G expenses. Furthermore, ComEd fails to offer any insight about why A&G expenses are lagging behind. (ICC Staff Exhibit 6.0 Corrected, p. 27)

Staff contends that ComEd witness Costello's claim that "… the fact that we have been successful in some areas does not imply that increases in other areas must be unreasonable" (ComEd Ex. 13.0 Corrected, p. 32) fails to address the real issue. Staff points out that Costello fails to explain the distinguishing characteristic of A&G expenses that would make them increase when other costs are declining. Furthermore, he fails to provide any corroborating evidence to support his contention that A&G expenses are more difficult to control than other costs. (ICC Staff Exhibit 17.0 Corrected, p. 23)

(d) BSC Costs

BSC was created in 2001 for the purpose of providing support services that are common to multiple Exelon affiliate companies. Specifically, BSC provides information technology support, human resource support, finance support, legal support, communications support, executive management support and corporate governance support. (ComEd Exhibit 5.0 Corrected, p 26) BSC has come to play a key role in the performance of the A&G functions, and accounts for 47% of unadjusted A&G expenses for the test year. (ComEd Ex. 5.0, p. 27)

Staff has two serious concerns about BSC, which, given that it accounts for 47% of unadjusted A&G expenses, has a tremendously significant impact on A&G expenses in the test year. ComEd claims that BSC provides efficiencies and cost savings that are passed along to Company. Staff contends that the A&G expenses proposed by ComEd, do not reflect these cost savings. Given that BSC accounts for a significant portion of A&G expenses, Staff posits that there should be some evidence of a reduction in A&G expenses.

In addition, Staff has serious questions about difficulties in reviewing and evaluating the reasonableness of the costs attributed to BSC. These concerns about BSC create serious doubt and uncertainty about ComEd's proposed increase in A&G expenses. ComEd witness Heintz states that the complexity of ComEd's direct assignment approach for A&G expenses prevents ComEd from employing the direct assignment approach used in ComEd's last delivery service rate case, Docket No. 01-0423. He explains the problem as follows:

> Notwithstanding ComEd's preference for functionalizing A&G expenses by direct assignment (as authorized by the ICC in its final order in Docket No. 01-0423), the information is no longer available to perform an accurate direct assignment. The reason is that, subsequent to the last distribution services general rate proceeding, ComEd has re-organized, and many administrative functions formerly performed within ComEd are now performed by Exelon Corporation's wholly-owned subsidiary, Exelon Business Services Company ("BSC"). Expenses for performing these functions are billed by BSC to ComEd and they are recorded in Account 923 –

> Outside Services Employed. Because the BSC bills are all recorded in a single account, it is impractical to perform the detailed analyses that are necessary to support a direct assignment methodology for A&G expenses.

(ComEd Ex. 11, pp. 17-18)

This statement raises fundamental questions about the transparency and quality of ComEd's functional allocation of A&G expenses and whether the reasonableness of these costs can readily be reviewed and evaluated. (ICC Staff Exhibit 17.0 Corrected, p. 26)

c. Corporate Governance Expenses

<u>Staff's Position</u>

Staff witness Dianna Hathhorn proposed an adjustment of $663,000 in operating expenses to reduce ComEd's corporate governance charges from Exelon Business Services Company ("BSC"). (ICC Staff Exhibit 1.0, pp. 8-12, Schedule 1.7) Ms. Hathhorn's adjustment calculates ComEd's corporate governance charges using the most recent actual 2004 values for the inputs to the formula used to allocate corporate governance charges, to better match the historical test year with actual 2004 activity. (ICC Staff Exhibit 1.0, p. 9) The Company used forecasted inputs prepared prior to the start of the year to calculate its allocation factors. (ComEd Ex. 18.0 Corrected, p. 5)

As set forth in Ms. Hathhorn's testimony, corporate governance costs are defined in Section 7 of ComEd's General Services Agreement ("GSA"), approved in Docket No. 00-0295 which was Attachment A to ICC Staff Exhibit 1.0. In the final GSA, which contains certain modifications by the Securities and Exchange Commission ("SEC"), corporate governance is defined as:

> "…those activities and services reasonably determined to be necessary for the lawful and effective management of Exelon System business. Corporate Governance Services may be supplied from functions such as accounting, finance, executive, strategic planning, legal, human resources/benefits, audit, corporate communications and public affairs, environmental health and safety, government affairs and policy, and investor relations…"

(See Attachment A for a complete copy of the GSA) Ms. Hathhorn testified that these costs are allocated from BSC to ComEd using the Modified Massachusetts Formula ("MMF"), which uses gross revenues, total assets, and direct labor as inputs to the allocation formula. The MMF used for the test year was calculated based upon 2004 projected gross revenues and direct labor, and assets at their 9/30/2003 value. (ICC Staff Exhibit 1.0, p. 9)

Since 2004 was the first year the MMF was used to allocate ComEd's corporate governance charges, Ms. Hathhorn explained that she conducted a reasonableness analysis based on the amounts of indirect corporate governance costs charged to ComEd versus its affiliates in 2004. (Tr., p. 1753) She testified that her analysis (See ICC Staff Exhibit 1.0, p. 11, Table 1) showed that ComEd and its regulated affiliate, PECO Energy Company ("PECO") received almost exactly the same ratio of direct to indirect corporate governance charges from BSC—11% direct and 89% indirect. Further, she stated that her analysis showed that the two non-regulated affiliates of ComEd-- Exelon Corporation ("Exelon"), and Exelon Generation Company LLC ("Genco")-- received almost exactly the same ratio of direct to indirect corporate governance charges from BSC, 28% direct and 72% indirect. Therefore, Ms. Hathhorn concluded that when compared to the regulated affiliates, the non-regulated affiliates received much lower percentages of indirect corporate governance costs, which indicates that indirect corporate governance costs were not allocated fairly and equitably among the Exelon family of companies in 2004. (ICC Staff Exhibit 1.0, p. 11, Table 1)

Ms. Hathhorn made clear in her rebuttal testimony and at the hearings that her adjustment was solely for ratemaking purposes, and that Staff does not advocate a change to the amount recorded under the methodology approved in the GSA. (ICC Staff Exhibit 12.0, p. 6 and Tr., p. 1738) Staff noted in its Initial Brief that no one claimed that Staff's adjustment is inconsistent with the GSA. (Staff IB, p. 50) Further, Staff contended that ComEd itself considered an adjustment to reflect the actual inputs in place of the estimated ones and the Commission often approves adjustments to test-years to change the amount actually recorded by a utility to a more appropriate amount for ratemaking purposes, such as average storm damage and tree trimming expense amounts. (*Id.*) Staff in its Initial Brief argued that (1) its adjustment from the amount actually recorded on the books of the utility to a proper test-year balance in no way violate test year principles, despite ComEd witness Houtsma claim in her testimony (ComEd Ex. 35.0, p. 2); (2) Ms. Houtsma contradicted herself at the evidentiary hearing; and (3) ComEd acknowledged that it has discretion under the GSA to adjust allocated amounts based on projections to using actual data (Tr., pp. 354, 454-456) but did not make the change because it was not material (Tr., pp. 360-361, 452). (*Id.*, pp. 50-51) Staff also pointed out in its Initial Brief that under the Public Utilities Act ("the Act"), amounts included in rates may be different than those calculated according to a Commission-approved affiliate interest allocation agreement, (See 220 ILCS 5/7-101(3)) given that Section 7-101(3) of Act states that consent or approval of an affiliate interest agreement, such as the GSA, by the Commission does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding. (*Id.*, p. 51)

d. Exelon BSC Expenses

Staff's Position

Staff witness Dianna Hathhorn testified that an adjustment to reduce ComEd's affiliate charges from BSC by $10,117,000 was necessary to reflect a normal level of test year costs in Accounts 921, Office Supplies and Expenses and Account 923, Outside Services Employed, rather than using the historical 2004 amounts, since the 2001 through 2004 amounts vary greatly-- from approximately $74 million in 2002 to a high of $119 million in the test year, 2004. (ICC Staff Exhibit 1.0, Schedule 1.8 and ICC Staff Exhibit 12.0, Schedule 12.8)

In her rebuttal testimony, Ms. Hathhorn modified her proposed adjustment to also account for Exelon Energy Delivery Shared Services ("EDSS") costs in the calculation of the four year average balance. This changed the range of ComEd's costs from a low of $77 million in 2002 to a high of $143 million in 2004. (ICC Staff Exhibit 12.0, Schedule 12.8, Column (h)) Ms. Hathhorn's revised adjustment of $10.117 million results in a test year normalized balance of $117.8 million.[3] However, Ms. Hathhorn testified that she could not accept ComEd's further refinement of the adjustment for centralization of BSC functions (ComEd Ex. 18.1, Schedule 1, line 14) because her modification to include the EDSS expenses in the four-year average accomplishes the same result. (ICC Staff Exhibit 12.0, Schedule 12.8, line 5) Further, she stated that she could not accept ComEd's centralization adjustment because there was no support for it, noting that ComEd's workpapers on the BSC portion provided only circular references-- from one data request response to another--with no underlying account balance or source documentation provided. (ICC Staff Exhibit 12.0, p. 14)

6. Incentive Compensation

<u>Staff's Position</u>

Staff witness Ebrey proposed an adjustment to disallow costs of the Company's Annual Incentive Plan ("AIP") and Long Term Incentive Plan ("LTIP") for five reasons. First, Ms. Ebrey stated that ComEd's incentive compensation plans are dependent upon financial goals of the Company which benefit shareholders and not ratepayers. (ICC Staff Exhibit 2.0, pp. 15-18) As a result, Ms. Ebrey concluded that these types of goals are based on circular reasoning; that is, the larger the rate increase granted, the more success ComEd will have in achieving its earnings goals. (ICC Staff Exhibit 2.0, p. 17) Further, she noted that since these goals primarily benefit shareholders, shareholders should bear the cost. (*Id.*) Second, Ms. Ebrey testified that the goals in the plans may not be met and, in that event, no cost would be incurred by ComEd yet ratepayers would have provided funding. (*Id.*, pp. 18-21) She was concerned that there was no mechanism to protect ratepayers should ComEd not achieve its 2005 level in the future. (*Id.*, p. 18) Third, Ms. Ebrey testified that ComEd's incentive compensation plans are discretionary and may be discontinued at any time. (*Id.*, pp. 21-22) Fourth, Ms. Ebrey stated there is not sufficient comparable historical data on which to determine if the test year level is reflective of a "normal" level. (*Id.*, p. 22) She testified that her concern

[3] ICC Staff Exhibit 12.0, Schedule 12.8 Line 4 Col. (h) $143,392,000 x 89.2% Jurisdictional Factor (Line 6) - $10,117,000 Staff Adjustment (Line 12)

results from a review of plan descriptions that indicates the plan has gone from a very basic plan with limited goals in 2002, to a much more complex plan in 2003-2004 and back to a simpler plan in 2005. (*Id.*) Finally, Ms. Ebrey testified that the disallowance of the costs of incentive compensation programs under the instant facts is consistent with prior Commission Orders. (*Id.*, pp. 23-24)

In rebuttal testimony, Ms. Ebrey clarified that the costs from both incentive compensation plans should be disallowed. (ICC Staff Exhibit 13.0, pp. 12-14) Further, Ms. Ebrey disagreed with assertions in ComEd's rebuttal testimony that it has satisfied the Commission's test for recovery of incentive compensation costs. Ms. Ebrey noted that the Commission has spoken for itself regarding the kind of evidence it needs to see when deciding what portion, if any, of incentive compensation costs should be recovered. (*Id.*, pp. 16-17) Ms. Ebrey testified and Staff argues in its Initial Brief that ComEd has not satisfied the Commission's test for recovery of incentive compensation costs. (ICC Staff Exhibit 13.0, p. 17; Staff IB, p. 54)

Staff further asserts that ComEd was unable to quantify any reductions to the requested rate increase associated with its incentive compensation plans. In response to ComEd's argument that reductions to incentive compensation would result in increases to other components of compensation, Staff pointed out that ComEd could not identify any increases to its total compensation package as a direct result of the Commission's disallowing $24 million of incentive compensation expense in ICC Docket 01-0423. (Staff IB, p. 55) Additionally, Staff noted that the Company could not cite any instance where it has filed for a rate decrease as a result of these alleged lower costs. (*Id.*)

7. Uncollectibles Expenses

Staff witness Ebrey proposed an adjustment to decrease the Company's test year uncollectibles expense, based upon a five-year average that produces an uncollectibles rate of 0.72%. Ms. Ebrey testified that the 0.85% uncollectibles rate proposed by the Company is higher than the overall uncollectibles rate in every one of the last five years and shows a 33% increase from the overall 2004 uncollectibles rate (.64%). (ICC Staff Exhibit 2.0, p. 26) She further noted that while Staff's proposed rate is also an increase (13%), Staff's rate is more representative on a going-forward basis because it reflects the Company's historic uncollectibles rates while allowing for an increase due to increased base rates. (*Id.*, pp. 26-27)

In rebuttal testimony, Staff witness Ebrey noted that the Company's proposed 0.85% uncollectibles rate, based upon its customer class analysis, is higher than the actual overall uncollectibles rate for 2004, which was only 0.64%. (ICC Staff Exhibit 13.0, pp. 23-25) Further, she stated that since the 0.72% uncollectibles rate proposed by Staff is less than the 0.85% uncollectibles rate proposed by ComEd, it would appear that Staff's proposal would be likely to more fully capture the effect of ComEd's more stringent credit and collection policies than would its own proposal. (*Id.*) Furthermore, Ms. Ebrey noted that ComEd's proposed overall uncollectibles as a percentage of base rate revenue for the test year is 0.72%, the same overall level that Staff is proposing. (*Id.*)

8. Charitable Contributions

Staff's Position

Staff witness Dianna Hathhorn testified that an adjustment to remove contributions to certain community organizations from the Company's miscellaneous general expenses was necessary. Her testimony focused on the important fact that Company's participation in such groups is a promotional and goodwill practice, designed primarily to bring the Company's name before the general public in such a way as to improve the image of the utility or to promote utility industry issues. (ICC Staff Exhibit 12.0, Schedule 12.9) In her rebuttal testimony, Ms. Hathhorn modified her proposed adjustment to remove those organizations that ComEd subsequently substantiated as charitable contributions rather than memberships. (ComEd Ex. 19.0 Revised, pp. 56-57) Therefore, Ms. Hathhorn's final adjustment of $204,000 consists of two components.

First, Ms. Hathhorn testified that her final adjustment includes those contributions which ComEd agreed should be removed, namely contributions to the Illinois Energy Association, the Metropolitan Club, the City of Chicago-Mayor's Office of Special Events, and the Illinois Business Roundtable. (ComEd Ex. 19.0 Revised, p. 57) Second, she stated that her final adjustment also includes the contribution to the Illinois Manufacturers Association ("IMA"), which ComEd continues to contest. Ms. Hathhorn's rebuttal testimony pointed out that the IMA invoice was clearly labeled a "Legislative Strategies" contribution, and her review of the IMA web site (www.ima-net.org) showed that the primary purpose of the organization is to monitor and influence legislation. Therefore, she concluded that ComEd's contribution must be disallowed from the revenue requirement, as Section 9-224 of the Act (220 ILCS 5/9-224) prohibits including in any rate or charge amounts expended for political activity or lobbying. (ICC Staff Exhibit 12.0, p. 16)

9. Procurement Case Expenses

Staff's Position

Staff witness Dianna Hathhorn opposed ComEd's proposal to amortize ComEd's estimated legal fees and expenses related to the procurement proceeding, Docket No. 05-0159, because the costs are not related to delivery services. Instead, she recommended those costs be recovered through the Supply Administration Charge ("SAC"). Her proposal assigns the cost of the procurement proceeding to those customers who benefit from the procurement process rather than to all customers including those who do not take supply from ComEd and those whose electric supply service has been declared competitive.

Ms. Hathhorn's adjustment also removes the unamortized balance of procurement expense from rate base. (ICC Staff Exhibit 1.0, Schedule 1.11 and ICC Staff Exhibit 12.0, Schedule 12.11). Ms. Hathhorn's procurement case expense adjustment results in a revenue requirement impact of $2,364,000 to operating expense and $2,849,000 to rate base. (ICC Staff Exhibit 12.0, Schedule 12.11) Her position on the rate base portion of this adjustment is addressed in the Rate Case Expense section, since the same principles apply to both adjustments.

Ms. Hathhorn further testified that an example of the inequity in ComEd's proposal to include costs from the procurement proceedings in delivery services rates, is that some of the expenses included in ComEd's procurement expense request are for an auction manager and staff, auction management expenses, and an auction advisor, but adopting ComEd's proposal would charge customers who only take delivery services from ComEd with costs related to ComEd's procurement proceeding and operations. (ICC Staff Exhibit 1.0, p. 19)

Staff, in its Initial Brief in response to ComEd's argument that "[t]he availability of this default supply service is a benefit to all retail customers, whether they take ComEd electric supply service or not" (ComEd Ex. 23.0, p. 7), argued that ComEd's argument is flawed because the obligation to serve existed before the procurement proceeding. (Staff IB, p. 60) Staff added that the procurement proceeding changed the method by which ComEd will obtain supply to meet this *existing* obligation, but it did not establish the obligation. The obligation to serve, and thus the availability of supply, remains unchanged by the procurement proceeding. (*Id.*) While Ms. Hathhorn did admit at the hearing that there may be a *de minimus* benefit to all customers of the procurement proceedings, (Tr., p. 1754), under her proposal customers are only charged when they procure power supply from ComEd. (*Id.*)

Ms. Hathhorn's testimony pointed out another inequity of ComEd's proposal by examining the impact on customers with demands greater than 3 megawatts (">3 MW customers"). She stated that in ICC Docket No. 05-0159, >3 MW customers argued that their service offering should be procured through fixed price products; however, ComEd declined this proposal.[4] Ms. Hathhorn noted that by charging the >3 MW customers procurement case fees and expenses, these customers will pay for a service they are eligible for but may not want. (ICC Staff Exhibit 1.0, p. 20)

In its Initial Brief, Staff identified the inconsistency in ComEd's proposal. Staff noted that ComEd's proposal charges some procurement expenses to all DST customers (ComEd Schedules WPB-2.3 and C-10) yet other procurement expenses are segregated and charged only through the SAC (ComEd Ex. 10.7). (Staff IB, p. 61) Staff argued that it is unclear how ComEd made - and will make in the future - the

[4] Docket No. 05-0159, ComEd Exhibit 10.0, pp. 55-57.

determination between which procurement expenses should affect the delivery services charge and which expenses affect only the SAC. Staff noted that ComEd has identified no valid reason for its inconsistent approach. (Staff IB, p. 61; ICC Staff Exhibit 12.0, pp. 18-19)

The final piece to Ms. Hathhorn's adjustment is that the amount to be recovered in the SAC must be adjusted for the estimated costs of two vendors not shown to be just and reasonable by ComEd. On page 2 of Schedule 12.11 of ICC Staff Exhibit 12.0, Ms. Hathhorn calculates that the procurement case expenses to be included in the SAC charge should be reduced by $566,667, resulting in, at Schedule 12.11, page 2, line 10, Staff's final proposed SAC costs of $3,255,947.

10. Rate Case Expenses

Staff's Position

See Staff's discussion under Section III.B.10f.

14. Payroll Taxes

Staff's Position

Staff witness Ebrey proposed an adjustment to reflect the effect on payroll taxes of her adjustments to incentive compensation costs as well as for the Company's own pro forma adjustment to incentive compensation expense. (ICC Staff Exhibit 2.0, pp. 24-25) For a discussion of Staff's Position with respect to incentive compensation, see Section III.C.6.

16. Gross Revenue Conversion Factor

Staff's Position

Staff presented its gross revenue conversion factor ("GRCF") in ICC Exhibit 1.0, Schedule 1.6. Staff's GRCF is multiplied by the income deficiency to determine the total amount of revenue required for the income deficiency and the associated increase in income tax expense and uncollectible expense. It is based upon the applicable federal tax rate, state income tax rate, and Staff's uncollectible rate, sponsored by Staff witness Ebrey in ICC Staff Exhibit 2.0, Schedule 2.5. (For Staff's discussion of the uncollectible rate, see Section III.C.7.)

E. Rate Of Return

1. Capital Structure

<u>Staff's Position</u>

While the Company proposes using an adjusted June 30, 2005, capital structure that contains 45.80% long-term debt and 54.20% common equity, Staff witness Ms. Sheena Kight recommends an adjusted capital structure containing 62.89% long-term debt and 37.11% Common Equity. (ICC Staff Ex. 4.0 Corrected, pp. 4-11, Schedule 4.1; ICC Staff Ex. 15.0 2nd Corrected, pp. 3-4) Staff and the Company agree that short-term debt should not be included in the capital structure since it is not currently financing rate base investments. In addition, Staff and the Company agree that ComEd's balance of preferred securities is zero. (ICC Staff Ex. 4.0 Corrected, p. 11) However, Staff and the Company disagree as to the balance and cost of long-term debt and common equity.

Staff notes that the primary dispute with regard to capital structure involves differing views on the appropriate adjustment to ComEd's June 30, 2005, equity balance given (1) the increase in common equity resulting from the Company's use of purchase accounting to record the 2000 merger of PECO Energy Company and Unicom Corporation (ComEd's corporate parent at the time of the merger) and (2) ComEd's subsequent transfer of its generating assets to an affiliate in 2001 at the restated value of those assets resulting from the application of purchase accounting. (*See* ICC Staff Exhibit 4.0 Corrected, pp. 4-6) The second area of dispute is whether Staff's adjusted capital structure is an appropriate and reasonable capital structure. Staff asserts that its proposed capital structure incorporates necessary and appropriate adjustments to ComEd's June 30, 2005, equity balance, represents an appropriate and reasonable capital structure for ComEd, and should be adopted by the Commission.

a. Staff's Additional Adjustments to ComEd's Actual Balance of Common Equity

Staff states that ComEd's proposed capital structure is based on its June 30, 2005, capital structure adjusted to exclude $2.292 billion of equity that resulted from the application of purchase accounting for the Unicom/PECO merger. (*See* ComEd Ex. 7.0, pp. 2, 6) Pursuant to purchase accounting ComEd's assets and liabilities were restated to their fair values as of the merger date, and the difference between the purchase price and the restated fair value of its assets and liabilities was recorded as goodwill. (*Id*., p. 6) The net effect of these purchase accounting entries was a $2.292 billion increase in ComEd's equity balance. (*Id*.; *see also* ICC Staff Exhibit 4.0 Corrected, pp. 4-5) ComEd witness Mr. Mitchell provided the following summary of the purchase accounting entries that resulted in the $2.292 billion increase in ComEd's equity balance:

Description	($millions) Increase/(Decrease) in Equity
Plant Write Downs	($4,791)
Deferred Taxes and ITCs	2,157
Pension, OPEB and Severance	144
Other Assets, Liabilities and Long Term Debt	77
Goodwill (net of amortization)	4,705
Net Increase in Equity	$2,292

(ComEd Ex. 7.0, p. 7) Staff notes that according to Mr. Mitchell all of these entries, including goodwill, were excluded from the common equity balance reflected in ComEd's proposed capital structure. (*Id.*; *see also* ICC Staff Exhibit 4.0 Corrected, pp. 4-6)

Staff witness Ms. Kight reviewed ComEd's proposed common equity adjustments and, although she agreed in general that adjustments were necessary, disagreed with certain aspects of ComEd's proposed adjustments. Since rates are based on original cost rate base, Ms. Kight agreed that 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. (ICC Staff Exhibit 4.0 Corrected, p. 5) Thus, Ms. Kight concluded that ComEd's June 30, 2005, capital structure, which reflects estimates of fair value for financial reporting purposes, should be adjusted to reflect depreciated original cost. (*Id.*) In other words, ComEd's actual capital structure for financial reporting purposes should be adjusted to the extent that purchase accounting and other entries have caused its actual capital structure to no longer reflect the capital supporting its depreciated original cost rate base.

Ms. Kight opposed the elements of ComEd's adjustments related to utility plant that it no longer owns (primarily reversal of the write downs of utility plant – subsequently transferred -- made to restate those assets at their estimated fair value pursuant to purchase accounting). Ms. Kight further explained that the deferred taxes and ITC's written down were largely, if not wholly, associated with that utility plant. (ICC Staff Exhibit 4.0 Corrected, p. 5) Ms. Kight opined that such reversals might be appropriate adjustments to ComEd's capital structure if it still owned that utility plant or had received (and retained) as compensation assets equal to the pre-write down value for that plant. (ICC Staff Exhibit 4.0 Corrected, p. 5) However, ComEd neither owns the plant assets that were written down nor received any assets in exchange. (*Id.*) Instead, ComEd transferred that plant to an affiliate at its estimated fair value (i.e., at its written down value) as a capital contribution, which did not produce any proceeds for ComEd (receiving treasury stock instead). (*Id.*; *see also* Staff Cross Ex. 14, pp. 97-98; Staff Cross Ex. 15, Item 5 – Other Events)

Staff argues that ComEd's transfer of its generation assets distorted the relationship between its actual capital structure and the capital supporting its depreciated original cost rate base. The generation assets ComEd transferred had an original cost book value of approximately $6.7 billion. (ICC Staff Cross Ex. 15, Item 5 – Other Events; Tr., p. 2465) As reflected in ComEd's 8-K, these assets were transferred at their new fair value cost basis (i.e., the write down value) but all of the goodwill resulting from the application of purchase accounting remained on ComEd's books. Staff submits that because these generating stations and related liabilities were transferred at their restated fair value cost basis (approximately $2 billion) and all goodwill remained on ComEd's books, ComEd's actual capital structure necessarily continues to reflect the difference between (1) the original cost value of the assets and liabilities transferred and (2) the fair value cost of those same assets and liabilities (notwithstanding that ComEd no longer owns these assets). Consequently, because those assets were not transferred at their book value and all goodwill remained on ComEd's books, ComEd's resulting actual capital structure was not reduced commensurate with the original cost book value of the assets and liabilities transferred.

Thus, Ms. Kight determined that notwithstanding ComEd's reversal of the purchase accounting adjustments, its proposed capital structure does not reflect the amount of capital originally invested in ComEd's remaining assets. (*Id*.) That is, ComEd's proposed capital structure overstates the amount of capital in use. (*Id*.) Specifically, ComEd's proposed $2.292 billion adjustment to common equity inappropriately includes the reversal of both write down of plant that ComEd no longer owns and the associated reduction to deferred income taxes and ITC's. (*Id*., pp. 5-6) Accordingly, Ms. Kight concluded that ComEd's balance of common equity should be reduced by an additional $2.634 billion (the net effect of excluding ComEd's reversal for the $4.791 billion plant write down less the $2.157 billion reduction to deferred income taxes and ITC's). (*Id*., p. 6) Removal of the adjustments associated with the transferred utility plant from ComEd's proposed capital structure results in a capital structure based on the unrecovered portion of the original investment in ComEd's **remaining** assets.

b. Reasonableness of Staff's Adjusted June 30, 2005 Capital Structure

Ms. Kight assessed whether it was appropriate to use Staff's adjusted capital structure to determine ComEd's overall rate of return. Ms. Kight explained that financial theory suggests capital structure affects the value of a firm and, therefore, its cost of capital, to the extent it affects the expected level of cash flows that accrue to outside parties (i.e., other than debt and stock holders). Employing debt as a source of capital reduces a company's income taxes, thereby reducing the cost of capital; however, as reliance on debt as a source of capital increases, so does the probability of default. As default becomes more probable, expected payments to attorneys, trustees, accountants and other outside parties increase. Further, cash flows decline as the company is forced to forego opportunities otherwise available to it had its financial condition been stronger, including the expected value of the income tax shield provided by debt financing. Beyond a certain point, a growing dependence on debt as a source of funds increases the overall cost of capital. Therefore, Ms. Kight opined, the Commission should not determine the overall rate of return from a utility's actual capital structure if the Commission concludes that capital structure adversely affects the overall cost of capital. (ICC Staff Exhibit 4.0 Corrected, pp. 6-7)

Ms. Kight further testified that an optimal capital structure would minimize the cost of capital and maintain a utility's financial integrity. However, determining whether a capital structure is optimal remains problematic because (1) the cost of capital is a continuous function of the capital structure, rendering its precise measurement along each segment of the range of possible capital structures problematic; (2) the optimal capital structure is a function of operating risk, which is dynamic; and (3) the relative costs of the different types of capital vary with dynamic market conditions. Consequently, Ms. Kight explained that one should determine whether a proposed capital structure is consistent with the financial strength necessary to access the capital markets under most conditions, and if so, whether the cost of that financial strength is reasonable. (*Id.*) To make these determinations, Ms. Kight compared Staff's proposed adjusted capital structure as of June 30, 2005 to utility benchmarks.

Ms. Kight explained that Standard & Poor's ("S&P") categorizes debt securities on the basis of the risk that a company will default on its interest or principal payment obligations. The resulting credit rating reflects both the operating and financial risks of a utility. Although no formula exists for determining a credit rating, S&P publishes utility benchmark values, by business profile score, for financial ratios it uses to determine credit ratings. S&P currently assigns ComEd a corporate credit rating of BBB+ and a business profile score of 4. Therefore, Ms. Kight compared the values for those benchmark financial ratios that result from combining Staff's proposed adjusted capital structure with components from Staff's proposed revenue requirement to S&P's benchmarks for utilities with an A or BBB credit rating and a business profile score of 4. According to S&P, utilities with a business profile score of 4 should have a funds from operation ("FFO") to interest coverage ("FFOIC") ratio between 3.5X and 4.2X for an A-rating and 2.5X to 3.5X for a BBB-rating. The benchmark ranges for the FFO to total debt ("FFO/Debt") coverage ratio is 20%-28% for A-rated utilities and 12%-20% for BBB-rated utilities. Ms. Kight testified that Staff's proposed adjusted capital structure results in a FFO to interest coverage ratio of 3.78X, which is indicative of an A credit rating, and a FFO to total debt coverage ratio of 18.04%, which is indicative of a BBB credit rating.[5] Thus, Ms. Kight concluded that Staff's proposed adjusted capital

[5] The FFO to interest coverage ratio equals interest divided into the sum of the funds available to shareholders, non-cash items (i.e. depreciation, amortization, deferred taxes and investment tax credits), and interest. The FFO to debt coverage ratio equals the sum of the funds available to shareholders and non-cash items divided by total debt. The coverage ratios developed by Ms. Kight determined each component of the ratio based on its contribution to Staff's recommended revenue requirement for ComEd. "Funds available to shareholders" equals Staff's recommended weighted cost of common equity for ComEd (i.e., the product of the cost of common equity and the common equity ratio). Depreciation, amortization, deferred taxes and investment tax credits equal Staff's recommended amounts for those items divided by Staff's recommended rate base. The interest component equals Staff's recommended weighted cost of debt in the capital structure for the Company (i.e., the product of the cost of debt and the debt (continued…)

structure is indicative of a level of financial strength that is commensurate with **at least** a BBB credit rating. (ICC Staff Exhibit 4.0 Corrected, pp. 7-8 (emphasis added)) Ms. Kight further testified that a BBB credit rating is indicative of an adequate degree of financial strength. A credit rating of BBB indicates an adequate capacity to meet financial commitments. A debt issuer with a BBB credit rating has access to debt capital under most, if not all, financial market conditions while taking greater advantage of the tax-deductibility of debt interest than capital structures that support higher credit ratings. (ICC Staff Exhibit 4.0 Corrected, p. 10)

Staff also notes that under its proposal ComEd's FFO/Debt ratio falls in the top third of the BBB range and its FFOIC ratio is in the middle third of the A range. Together, the two ratios indicate that Staff's proposed rates are sufficient to support financial strength that is commensurate with a credit rating of "A-" and is therefore consistent with the "A-"credit rating that the Company purports to target. (ICC Staff Exhibit 15.0 2nd Corrected, pp. 2-3) Table 1 presents the coverage ratios for the financial guidelines for the business profile "4" as well as those resulting from Staff's proposed capital structure and capital costs and ComEd's proposed capital structure and capital costs.

Table 1

	AA	A	BBB
Financial Guideline Ratios			
FFOIC	4.2-5X	3.5-4.2X	2.5-3.5X
FFO/Debt	28-35%	20-28%	12-20%
Staff Proposal			
FFOIC		3.78X	
FFO/Debt			18.04%
ComEd Proposal			
FFOIC	5.42X		
FFO/Debt	28.62%		

Staff submits that Table 1 also illustrates that ComEd's proposed capital structure results in ratios that are commensurate with an "AA" credit rating, instead of the "A-" credit rating ComEd professes to target. (ICC Staff Ex. 15.0 2nd Corrected, pp. 2-3, ComEd Ex. 20.0, p. 6)

Ms. Kight chose not to use a direct measure of capital structure such as the debt to total capital ratio ("debt ratio") because the debt ratio is less important in determining credit ratings. Unlike the FFO interest coverage and FFO to total debt ratios, the debt

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ratio). Total debt equals Staff's recommended percentage of debt in ComEd's capital structure. (ICC Staff Ex. 4.0 Corrected, pp. 9-10) ratio neither reflects the cost of a company's debt nor the cash flows available to meet its debt service obligations. Staff also observes that the amount of debt in ComEd's capital structure includes Transitional Funding Notes ("TFNs", also known as Transitional Funding Instruments or "TFIs"). (Tr. p. 1845) The rating agencies exclude TFNs when assessing ComEd's financial risk and credit rating financial metric calculations. (IIEC Exhibit 7.0, p. 15; *see also* ComEd Ex. 20.0, p. 29) Staff explains that the debt ratio under its proposed capital structure would be around 45% excluding the TFNs. That debt ratio is in the top third of the S&P ratio range for a BBB credit rating. (Tr., pp. 1845-1846) Thus, even if debt ratio was an appropriate consideration, the debt ratio under Staff's proposed capital structure supports at least a BBB+ credit rating when TFNs are excluded, if not higher.

Staff also provided testimony concerning the effect of excluding the TFIs for the FFOIC and FFO/Debt credit metric calculations.[6] When the TFIs are excluded from the credit metric calculations, Staff's cost of capital recommendation would result in an FFO/Debt and FFOIC ratios within the low to middle benchmark range for a BBB credit rating. Although the credit metric calculations without TFIs continue to reflect an adequate degree of financial strength, they do not produce ratios consistent with the A-/BBB+ credit ratings supported by the calculations including TFIs.

Staff explained that if the Commission concluded it were appropriate to impute a capital structure that would achieve credit metrics consistent with A-/BBB+ credit ratings (i.e., consistent with the credit metrics achieved including TFIs), ComEd's equity ratio would need to be increased to approximately 45.5%. Table 2 presents the effect of a TFI Adjustment on the FFOIC and FFO/Debt ratios under Staff's cost of capital proposal. Table 2 also presents the common equity ratio, combined with Staff's proposed costs of common equity and debt, that would produce credit metrics similar to those that Staff's cost of capital proposal produces without the TFI Adjustment ("Target A-/BBB+").

[6] The TFI Adjustment comprises three adjustments: (1) removal of $1,150 million in Transitional Funding Trust Notes ("TFTNs") from ComEd's balance of debt; (2) removal of $65.3 million in TFTN interest from ComEd's total interest charges; and (3) removal of $340 million in annual TFTN redemptions from ComEd's operating cash flows. (ICC Staff Exhibit 15.0 2nd Corrected, p. 7)

Table 2-ComEd Financial Ratios with TFI Adjustment

	Equity	A	BBB	BB
Financial Guideline Ratios				
FFOIC		3.5-4.2X	2.5-3.5X	1.5-2.5X
FFO/Debt		20-28%	12-20%	8-12%
Staff Proposal	37.11%			
FFOIC			3.06X	
FFO/Debt			13.91%	
Target A-/BBB+	45.5%			
FFOIC		3.69X		
FFO/Debt			18.19%	

Staff does not support imputing a capital structure to achieve credit metrics excluding TFIs consistent with A-/BBB+ credit ratings since Ms. Kight determined that this would ultimately lead to a higher rate of return on rate base for ComEd. Staff's recommended cost of capital is 7.86%. Combining a capital structure with a 45.5% common equity ratio and 54.5% debt ratio (to achieve credit metrics excluding TFIs consistent with A-/BBB+ credit ratings) with Staff's recommended costs of debt and common equity would result in a 8.17% cost of capital. Staff notes that in Docket No. 98-0319, ComEd claimed that its proposed use of the proceeds from issuing TFNs would lower its cost of capital.[7] Consequently, Staff submits that it would be unfair to ratepayers to authorize ComEd a higher rate of return on rate base on the basis that the TFNs require ComEd to maintain a higher common equity ratio than had the TFNs not been issued.

Staff also presented testimony indicating that, under Ms. Kight's proposed capital structure, issuance of the TFNs does not increase the cost of capital in comparison to that which would have existed had no TFNs been issued. Staff explained that because the TFNs had a AAA credit rating at the time they were issued in December of 1998 and ComEd was rated BBB at that time, the interest rate on the TFNs is lower than that which ComEd would have paid had it issued conventional debt at that time. Hence, Ms. Kight examined ComEd's cost of capital had it issued conventional debt instead of TFIs. On December 15, 1998, the 10-year corporate bond yield for electric companies with a credit rating of BBB was 6.32%. Replacing the TFNs in the long-term debt schedule with conventional debt at a rate of 6.32% increases the embedded cost of debt from 6.48% to 6.65%. At an embedded cost of debt of 6.65%, Staff's proposed capital structure, rate base and non-cash operating expenses results in a FFOIC ratio of 3.67X[8], a FFO/Debt ratio of 17.74%[8], and an overall cost of capital of 7.96%, ten basis points higher than Staff's recommended cost of capital.

[7] Order, Docket No. 98-0319, July 21, 1998, pp. 21-22.

[8] Staff notes these ratios are consistent with an "A-/BBB+" credit rating.

In summary, Staff maintains that the imputed capital structure of 45.5% equity and 54.5% debt that is necessary to maintain TFI-adjusted financial benchmarks indicative of A-/BBB+ credit ratings would increase the overall cost of capital from Staff's proposed 7.86% to 8.17%. The Order in Docket No. 98-0319 found that "the record reasonably demonstrates that issuance of the Notes [(i.e., TFNs)] and application of the proceeds as proposed by ComEd will result in a reduction in its overall cost of capital." (Order, Docket 98-0319, July 21, 1998, p. 22) Staff argues that since the standard is and should remain that TFNs do not increase the cost of capital in comparison to that which would have existed had no TFNs been issued, the Commission should not impute a capital structure with a higher proportion of common equity on the basis of ratios calculated with the TFI Adjustment.

2. Cost of Long-Term Debt

Staff's Position

Staff witness Ms. Kight determined that ComEd's embedded cost of long-term debt for June 30, 2005 equals 6.48%. (ICC Staff Exhibit 4.0 Corrected, pp. 3-4; Schedule 4.2, p. 3) To make this determination Ms. Kight prepared a December 31, 2004, debt schedule (Schedule 4.2, pp. 4-6) making certain adjustments to the December 31, 2004 debt schedule presented on ComEd's Schedule D-3 Revised. First, Ms. Kight used the ending balances for unamortized losses presented in ComEd's 2004 Form 21 ILCC on pages 24a-24d for all issues redeemed before 1998. Second, Ms. Kight used straight line amortization of the Net (Gain) or Loss from the date reacquired to December 31, 2004 to determine the December 31, 2004 unamortized balance for the issues reacquired during 2004. Finally, Ms. Kight adjusted the annual amortization of debt discount, premium, and expense to reflect straight-line amortization of each issue's December 31, 2004 unamortized balances over its remaining life. (*Id.*) Ms. Kight then prepared a June 30, 2005 debt schedule (Schedule 4.2, pp. 1-3) by simply updating the 2004 debt schedule to reflect the additional annual amortization of debt discount, premium, and expense and the annual sinking fund redemption, the retirement of two issues, and the issuance of one new issue. (ICC Staff Exhibit 4.0 Corrected, p. 4)

Staff notes that ComEd's initial response to Ms. Kight's determination that ComEd's embedded cost of long-term debt for June 30, 2005 equals 6.48% was to simply contend that she failed to use the balances and amortization amounts provided by the Company in its data request response (attached as ComEd Exhibits 20.5a and 20.5b). (ComEd Ex. 20.0, pp. 28-29) Ms. Kight responded that she did use the balance presented in ComEd Exhibit 20.5a, but did not use the balances and amortization provided in ComEd Exhibit 20.5b because some of those numbers did not reflect straight line amortization. (ICC Staff Exhibit 15.0 2nd Corrected, p. 5) Rather, the loss on reacquired debt presented in Ms. Kight's long-term debt schedule reflects the use of straight line amortization. (*Id.*) Specifically, Ms. Kight began with the ending balances for unamortized loss and gain on reacquired debt presented on pages 24a and 24b of

ComEd's 2004 Form 21 ILCC, and set the annual amortization of loss to that which would recover that loss in equal amounts each year (i.e., straight-line amortization), consistent with the Commission's rule regarding the amortization of Unamortized Loss on Reacquired Debt. (*Id*., see General Instruction 17 of the "Uniform System of Accounts for Electric Utilities", 18 CFR 101 (2003), as adopted by 83 Ill. Adm. Code 415.10, subject to the exceptions set forth in 83 Ill. Adm. Code 415.380) Ms. Kight calculated the ending balance for June 30, 2005 by subtracting 6-months of amortization from the unamortized balance at December 31, 2004. In addition, she made an adjustment (also provided in ComEd Ex. 20.5a) to reflect the generation-related unamortized loss on reacquired debt that was written off in December 1997. (ICC Staff Exhibit 15.0 2nd Corrected, p. 5)

Ms. Kight further explained why and how she determined that the amounts contained in ComEd's Exhibit 20.5b failed to reflect straight-line amortization:

> To illustrate, the unamortized balances of loss on reacquired debt for the 8.750%, Series 30 as of December 31, 2004, are the same on ICC Staff Exhibit 4.0, Schedule 4.2 and ComEd Ex. 20.5b. However, the June 30, 2005 unamortized balances differ. The annual amortization of Series 30 loss is approximately $90,900 using straight line amortization. Therefore, the June 30, 2005 balance should equal the December 31, 2004 balance of $772,849 minus half of the $90,900 annual amortization, or approximately $727,400. However, ComEd Ex. 20.5b lists the June 30, 2005 balance as $647,306. The approximately $80,000 difference between the two June 30, 2005 balances indicates that ComEd's balance does not reflect straight line amortization.

(*Id*., p. 6)

Staff notes that the surrebuttal testimony of ComEd witness Mr. Mitchell makes the conclusory assertion that he does not agree with Ms. Kight's position "because the balances and amortization amounts shown on ComEd Exhibit 20.5b are accurate and in accordance with applicable accounting and rate making principles." (ComEd Ex. 37.0 2nd Corrected, p. 24) Staff notes that ComEd did not offer any analysis or explanation attempting to refute Ms. Kight's specific demonstration that ComEd's balances and amortization amounts do not reflect straight line amortization. Given that General Instruction 17 of the Uniform System of Accounts for Electric Utilities provides for the use of straight line amortization, Staff submits that Ms. Kight's recommended cost of long term debt is the only recommendation supported by the record that is consistent with Part 415.

3. Cost of Common Equity

Staff's Position

Staff witness Michael McNally estimated ComEd's investor-required rate of return on common equity to be 10.19%. (ICC Staff Exhibit 5.0, p. 18) Mr. McNally measured the investor-required rate of return on common equity with discounted cash flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses. Mr. McNally applied those models to a sample of utility companies ("Comparable Sample") chosen on the basis of the comparability of their financial and operating ratios to those of ComEd. Mr. McNally's sample selection analysis employed six financial and operating ratios, using the average from the period 2002-2004 to normalize the ratios. He conducted a principal components analysis of those financial and operating ratios for the 112 market-traded electric, natural gas, and water companies on *Standard & Poor's Utility Compustat* tape that had sufficient data to calculate the ratios. After calculating the scores for each principal component, he rank-ordered the companies in terms of least relative distance from ComEd's target scores. The Comparable Sample consists of the eight utilities the least distance from, and therefore, the most comparable to, ComEd that are assigned an S&P business profile score of three to five; have growth rates from Zacks Investment Research, Inc. ("Zacks"); and have neither pending nor recently completed significant mergers, acquisitions, or divestitures. (ICC Staff Exhibit 5.0, pp. 2-4)

Mr. McNally explained that the DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. The companies in Mr. McNally's Comparable Sample pay dividends quarterly. Therefore, Mr. McNally applied a constant-growth quarterly DCF model. (ICC Staff Exhibit 5.0, p. 5)

Mr. McNally testified that the DCF methodology requires a growth rate that reflects the expectations of investors. Mr. McNally measured the market-consensus expected growth rates with projections published by Zacks. The growth rate estimates were combined with the closing stock prices and dividend data as of November 17, 2005. Based on this growth, stock price, and dividend data, Mr. McNally's DCF estimates of the cost of common equity was 9.36% for the Comparable Sample. (ICC Staff Exhibit 5.0, p. 8)

Mr. McNally's testimony also pointed out that according to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with the theory that investors are risk-averse and that, in equilibrium, two securities with equal quantities of risk have equal required rates of return. Mr. McNally used a one-factor risk premium model, the Capital Asset Pricing Model ("CAPM"), to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification. (ICC Staff Exhibit 5.0, pp. 8-9)

Mr. McNally further testified that the CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. For the beta parameter, Mr. McNally combined betas from Value Line and a regression analysis. The average Value Line beta estimate was 0.81, while the regression beta estimate was 0.62. (ICC Staff Exhibit 5.0, p. 16) For the risk-free rate parameter, Mr. McNally considered the 4.06% yield on four-week U.S. Treasury bills and the 4.81% yield on twenty-year U.S. Treasury bonds. Both estimates were measured as of November 17, 2005. Forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 5.4% and 5.9%. Thus, Mr. McNally concluded that the U.S. T-bond yield is currently the superior proxy for the long-term risk-free rate. (ICC Staff Exhibit 5.0, pp. 10-13) Finally, for the expected rate of return on the market parameter, Mr. McNally conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis estimated that the expected rate of return on the market equals 13.42%. (ICC Staff Exhibit 5.0, p. 14) Inputting those three parameters into the CAPM, Mr. McNally calculated a cost of common equity estimate of 11.01% for the Comparable Sample. (ICC Staff Exhibit 5.0, p. 17)

Based on his DCF and risk premium models, Mr. McNally estimated that the cost of common equity for the Comparable Sample is 10.19%. To determine the suitability of that cost of equity estimate for ComEd, Mr. McNally assessed the risk level of his Comparable Sample relative to that of ComEd. To begin with, the companies composing the Comparable Sample were selected based on the similarity of their financial and operating ratios to those of ComEd. Further, the similarity in risk of the resulting Comparable Sample to ComEd is confirmed by the similarity in the sample average credit rating, business profile score, and factor scores to those of ComEd. Thus, Mr. McNally concluded that the Comparable Sample appropriately reflects the risk level of ComEd and no risk adjustment is necessary. (ICC Staff Exhibit 5.0, pp. 17-18)

a. GDP Growth Rate

<u>Staff's Position</u>

Mr. McNally testified that the difference between Staff's and ComEd's cost of equity estimates is due almost entirely to Dr. Hadaway's inappropriate use of an economy-wide GDP growth rate as a proxy for the growth of the individual companies in his samples, which leads to an overstated cost of equity estimate. (ICC Staff Exhibit. 5.0, pp. 23-24) The Company failed to demonstrate that Dr. Hadaway's GDP growth rate estimate is a reasonable proxy for the growth of his individual sample companies. (ICC Staff Exhibit 16.0, p. 7) To the contrary, the record evidence indicates that Dr. Hadaway's approach is not appropriate.

First, Mr. McNally testified that the considerable divergence of Dr. Hadaway's 6.60% economy-wide GDP growth rate estimate from the three distinct company-specific growth rate estimates Dr. Hadaway employed suggests that his historical GDP growth rate is not a reasonable estimate of the sustainable growth of the individual companies in his samples. The sample averages for each of the three company-specific growth rate estimates for the companies in both of Dr. Hadaway's samples were quite consistent, all falling within a range of approximately one percentage point, from 3.41% to 4.43%. In contrast, the 6.60% GDP growth rate is more than two percentage points higher than the *highest* of any of the other three estimate averages for either sample. (ICC Staff Exhibit 5.0, p. 20)

Second, Mr. McNally testified that the Value Line earnings retention rate forecasts for the companies in Dr. Hadaway's samples, upon which Dr. Hadaway relied to develop his B*R growth rates, also indicate that 6.60% is not a reasonable estimate of the sustainable growth of the individual companies in his samples. As the B*R growth rate model indicates, a company's expected sustainable future growth is a product of the expected rate of return on new investment, R, and the percentage of earnings expected to be reinvested in the company (i.e., the retention rate), B. The greater the rate of return on new investment and the earnings retention rate, the greater the growth rate. Conversely, the lower the rate of return on new investment and the earnings retention rate, the lower the growth rate. Given the Value Line retention rate forecasts, the return on retained earnings for the companies in his samples would have to average over 20%, which is almost twice the 11.0% cost of equity Dr. Hadaway estimated for those companies, in order to sustain 6.60% growth.[9] Conversely, given Dr. Hadaway's 11.0% final cost of equity estimate, the retention rate for those companies would have to average 60%, which is almost twice the average of the Value Line retention rate forecasts, which Dr. Hadaway relied upon for his analysis, in order to sustain 6.60% growth. Thus, a 6.60% growth expectation is both inconsistent with the rest of Dr. Hadaway's analysis and unlikely to be embraced by investors. (ICC Staff Exhibit 5.0, pp. 20-21) Mr. McNally further pointed out in his testimony that alternatively, if one assumes, for internal consistency, that both Dr. Hadaway's 11.0% final cost of equity recommendation and the Value Line retention rate forecasts Dr. Hadaway relied on are fairly reasonable estimates, then the sustainable growth rate for the companies in his LDC Sample and Electric Sample would average approximately 3.5% and 3.74%, respectively. Those estimates fall squarely within the 3.41% to 4.43% range of the sample averages for the three company-specific growth rates Dr. Hadaway employed and, thus, are clearly much more comparable to the company-specific growth rates Dr. Hadaway employed than to Dr. Hadaway's GDP growth rate estimate of 6.60%. (ICC Staff Exhibit 5.0, p. 23)

In his testimony Mr. McNally testified that the Company's argument for the use of an economy-wide GDP growth rate as a proxy for the growth of the individual utility companies in Dr. Hadaway's samples rests on the implicit assumption that investors expect the long-term growth rates for those utilities to be similar to Dr. Hadaway's

[9] In fact, the Value Line forecasts for 2008-2010 reflect slightly higher retention rates than the actual and forecasted retention rates published in Value Line for 2000-2006 for the companies in Dr. Hadaway's samples. Thus, based on 2000-2006 retention rates, the companies would have to earn even higher returns in order to grow at the 6.60% rate Dr. Hadaway employed in his DCF analyses. (ICC Staff Exhibit 16.0, p. 11)

estimate of the average long-term growth rate for the overall economy. However, Mr. McNally noted that ComEd has provided no information to demonstrate that the companies in Dr. Hadaway's samples are average growth companies. To the contrary, the data underlying Dr. Hadaway's own analysis suggests that the utility companies composing his samples are below average growth companies. Specifically, the retention rate for utility companies is typically well below average, as evidenced by the historical, current, and Value Line forecasts of the retention rates of the companies in Dr. Hadaway's samples relative to the average retention rate for the companies composing the S&P 500. Further, one would expect utilities overall to earn below average returns due to the below average risk reflected in their below average betas (i.e., betas less than one), such as the 0.81 and 0.74 average betas Dr. Hadaway adopted for his LDC Sample and Electric Sample, respectively. Since growth is a function of those below average earnings retention rates and the below average return on those retained earnings, one would clearly expect *below average* growth for utilities. (ICC Staff Exhibit 5.0, pp. 21-22) In its initial brief, Staff explained that the Company's entire argument rests on the hope that the Commission will completely disregard the consistent, established patterns from the available data and simply accept the unfounded suggestion that investors expect the long-term future for utilities, relative to the overall market, to be significantly different from both the past and present as well as from current projections of the future three to five years hence.

Staff also argued in its initial brief that even if one accepts the use of a GDP estimate as a proxy for the growth of the individual companies in Dr. Hadaway's samples despite the above arguments, the accuracy of Dr. Hadaway's long-term GDP growth rate estimate as a gauge of long-term GDP growth expectations is highly questionable. The Company failed to demonstrate that investors set their long-term expectations of future GDP growth based on growth achieved over that past 57 years, much less that they derive their expectations in the peculiar manner Dr. Hadaway did. Furthermore, the actual, published GDP forecasts Staff and IIEC cited indicate that expectations for future GDP growth are significantly lower than the GDP growth rate Dr. Hadaway employed. (ICC Staff Exhibit 16.0, p. 8; IIEC Exhibit 3.0, pp. 3, and 25-26) Thus, it is highly dubious to assume that investors expect 6.60% long-term growth for the overall economy, as measured by GDP, much less for utilities specifically.

Finally, Staff in its initial brief argued that even if one ignores all of the foregoing arguments, the companies in Dr. Hadaway's samples cannot sustain a 6.60% growth rate given their current and forecasted dividend policies, even if one accepts the Company's supposition that investors might expect a return as high as 12.55%. Thus, even in the unlikely event that investors do expect very long-run growth rates to be approximately 6.60%, they must also expect a significant change to those companies' dividend payout policies, all else equal. That change must be reflected in the DCF model, if one wishes to obtain an unbiased cost of equity estimate; unfortunately, the Company's analysis does not incorporate the necessary shift in dividend payment policies. Thus, not only does the Company rely on the unfounded assumption that investors expect a dramatic rise in retention rates, but its analysis also implies that that rise in retention rates has already occurred, since it does not model any transition from the current retention rates to the higher retention rates that would be needed over the long run. In doing so, the Company effectively overstates ComEd's cost of equity by combining the higher dividend yield resulting from the lower actual current retention rate with the higher growth rate associated with a higher assumed future retention rate. (ICC Staff Exhibit 16.0, pp. 10-11) For all of the foregoing reasons, Staff argued that Dr. Hadaway's application of his GDP growth rate estimate as a proxy for the growth of the individual companies in his samples is inappropriate and should be rejected.

b. Investment Bank Analysis

Staff's Position

Mr. McNally testified that uncertainties regarding the CUB/CCSAO/City analysis rendered the resulting cost of equity estimate inappropriate for rate setting purposes. Mr. McNally pointed out that CUB/CCSAO/City estimated ComEd's cost of equity by inference from the weighted average cost of capital ("WACC") calculated by Morgan Stanley for the merger of Exelon and PS&G. However, in order to back out the cost of equity from the investment bankers' WACC estimates, CUB/CCSAO/City first had to make numerous assumptions. He further testified that unfortunately, we do not know if Mr. Bodmer's assumptions were the same as those the investment bankers used. Thus, we do not know if the CUB/CCSAO/City cost of equity estimate is the same as that calculated by the investment bankers. For example, we do not know if the investment bankers used the same approach to determining the cost of debt, what mix of debt maturities they used, or if they included short-term debt. Further, it is unclear whether the Morgan Stanley analysis was for ComEd and PECO separately or for the proposed combined entity. Mr. McNally went on to state that we also do not know if the investment bankers used the same capital structure or made the same assumptions regarding the treatment of transitional funding instruments. Because of all of these unknowns, the Commission cannot be certain that the investment bankers used the same 7.74% cost of equity Mr. Bodmer inferred or, even if they did, that that estimate represents the required rate of return on equity appropriate for rate setting purposes. (ICC Staff Exhibit 16.0, pp. 15-16)

c. Market to Book Ratio

Staff's Position

Staff witness McNally testified that the CUB/CCSAO/City market to book value analysis is not useful for establishing ComEd's cost of common equity for several reasons. First, according to Mr. McNally market to book value ratios combine the discounted value of future cash flows with historical book earnings. The numerator and denominator of the ratio are inconsistent with respect to time and construction. Second, Dr. Bodmer's market to book value analysis is based on the premise that one should expect a utility company to <u>precisely</u> earn its cost of capital on a continuing basis. That premise is oversimplified. There are many utility ratemaking practices (e.g., deferred taxes and depreciation) that could result in a utility's market value exceeding its book value. That is, the authorized return for each company in his sample is not the only factor influencing its earnings. Thus, a market to book ratio in excess of one does not necessarily mean the authorized rate of return is too high. Third, the Value Line betas for the 71 companies used in his analysis range from 0.50 to 1.75, indicating substantial variation in the riskiness of those companies. Yet, his analysis suggests that there is a single correct cost of equity (i.e., 5.65%), that which would equate market value to book value, for all 71 companies in his analysis. In addition, according to Mr. McNally, even if Mr. Bodmer were correct that the market to book value ratio for a utility that earned its required rate of return on common equity would equal one, companies with different risks must have different required rates of return. Thus, Mr. Bodmer's cross-sectional analysis is useless for establishing ComEd's cost of common equity given that he failed to establish that ComEd's risk is equal to the average risk of the 71 companies used in his analysis. (ICC Staff Exhibit 16.0, pp. 21-22)

4. Overall Cost of Capital

Staff's Position

Using Staff's recommended capital structure, cost of long-term debt, and cost of common equity, Staff witness Ms. Kight recommends an overall cost of capital for ComEd of 7.86%. (ICC Staff Exhibit 4.0 Corrected, pp. 2, 11, Schedule 4.1; ICC Staff Exhibit 15.0, p. 1) Staff recommended a cost of equity equal to 10.19%. (ICC Staff Exhibit 16.0, p. 2)

F. Cost of Service Issues

1. Embedded Cost of Service Study

Staff's Position

Staff does not object to ComEd's embedded cost of service study. (ICC Staff Exhibit 6.0, pp. 35-36) An embedded cost of service study functionalizes and classifies the utility's costs for Production (if any), Transmission, Distribution, and Customer-related ("P-T-D-C") functions. (ComEd Ex. 11.0, p. 5) ComEd has allocated costs among rate classes in a manner that is similar to what was approved by the Commission in its previous delivery service rate cases. (*Id.*, p. 6) Staff found no issue that would prevent its acceptance for ratemaking purposes; therefore, Staff does not object to the study. (ICC Staff Exhibit 6.0, p. 36)

2. Minimum Distribution System

Staff's Position

Staff challenges the minimum system to allocate distribution costs ("minimum distribution system") proposed by Alan Chalfant's (IIEC Exhibit 2.0) and David McClanahan's (BOMA Exhibit 2.0).. The minimum system is a flawed concept that the Commission has consistently rejected in the past.

The minimum system is a flawed concept that relies on a distant relationship between distribution costs and the number of customers as a basis for shifting costs from the demand to the customer function and thereby benefit large customers at the expense of smaller customers on the system. It is true that an important function of the distribution system is to connect customers to the system. However, the most relevant factor in determining the costs of connection is not the number of customers, but rather the location of customers within the utility's service territory. The cost of connecting one rural customer may be far higher than connecting a dozen customers in a multifamily dwelling in an urban setting. Differences such as this undermine the use of the number of customers as a determinant of distribution plant costs. (ICC Staff Exhibit 17.0 Corrected, pp. 40-41)

Staff also cites hearings in which the Commission has rejected the allocation of distribution costs on a customer basis (*See* Order, Docket No. 01-0444 (MidAmerica), p. 19 (March 27, 2002); Order, Docket No. 00-0802 (Ameren), pp. 42-43 (Dec. 11, 2001); and Order, Docket No. 99-0121 (CIPS), p. 71 (Aug. 25, 1999)) since that manual was written in January 1992 (BOMA Ex. 2.0, p. 13). Moreover, Staff points out that no electric or gas utility in Illinois currently employs a minimum system to allocate costs among customer classes. (ICC Staff Exhibit 17.0 Corrected, p. 41)

Staff is also concerned that the BOMA witnesses have not explained how the minimum distribution system would be implemented, and therefore, the Commission does not have an accurate understanding of what BOMA is really proposing.

Staff recognizes that BOMA is recommending that ComEd "recognize a minimum distribution component in its next delivery service rate case or, at the very least, make available to parties the results of either a zero intercept analysis or minimum system study of its distribution Accounts 364 through 369." (IIEC Exhibit 2.0, p. 15) Staff's response is that BOMA's proposal should be rejected because the minimum system is flawed by nature and should not be used in this or any future rate proceedings. (ICC Staff Exhibit 17.0 Corrected, p. 42)

H. Rate Design

Staff's Position

Staff proposes that the rate design approved by the Commission should conform to the revenue requirement it adopts. ComEd's proposed rates should be revised to reflect Staff's proposals to (1) shift cost recovery from fixed to variable charges and (2) base demand charges for customers with interval meters on peak demands, rather than 24 hour demands as ComEd proposes. In addition, all rates should be adjusted upwards or downwards on an equal percentage basis to conform to the revenue requirement approved by the Commission in this case. (Tr., p. 582-85)

3. Environmental Cost Rate Redesign

Staff's Position

Staff recommends that environmental costs be factored into usage charges. (ICC Staff Exhibit 6.0 Corrected, pp. 38, 41) Staff avers that ComEd's proposed rate design fails to account the environmental cost of producing power, such as costs associated with global warming. Staff argue that there is a correlation between societal environmental costs and usage (i.e., increased usage generally results in increased environmental impacts), and that rates should be designed to increase recovery of the revenue requirement through usage sensitive charges to reflect the increased environmental costs imposed by higher usage.

Staff proposes that all facilities charges for ComEd customers should be reduced by 20%. There would also be a corresponding increase in delivery and demand charges to allow ComEd to recover the lost revenue from customer. Staff's proposal is designed to be revenue neutral on a class basis, meaning, residential delivery charges would be raised to the level that fully offsets the revenue loss from the reduction in residential facilities charges. Staff believes that this environmental rate redesign for residential customers will have no impact on non-residential rates. Similarly, the corresponding rate redesigns for individual non-residential classes would not affect rates for other non-residential classes or for residential customers. (ICC Staff Exhibit 6.0 Corrected, p. 43)

Staff informs us that environmental costs, are real, but are also quite difficult to quantify; that the cost to society from consumption of a kWh of electricity is virtually impossible to measure. Energy consumers contribute to the problem of global warming through their consumption of fossil fuels, whether to power an automobile, heat a home or to use electricity. Those electricity demands are met at least in part by power plants that consume fossil fuels and release carbon dioxide which is considered the primary contributor to global warming. (ICC Staff Exhibit 6.0 Corrected, p. 37) Therefore, Staff is relying on experience to develop its 20% reduction figure. Staff's rationale is that the selection of a 20% reduction in customer charges recognizes that environmental impacts are indeed significant, however, it still permits the utility to recover 80% of customer costs through up-front monthly charges. Staff proffers that this is a reasonable tradeoff between the interests of the environment and the utility. (ICC Staff Exhibit 6.0 Corrected, p. 43)

Staff states that its proposal provides a price signal to ratepayers that more accurately reflects the impact of their consumption on the environment. Therefore, its proposal will promote consumer consideration of environmental concerns in consumption decisions. Moreover, Staff avers that the impacts of its proposal on ratepayers would be relatively minimal.

Staff's proposal is not intended to increase the overall rates paid by ComEd customers, and would have a relatively minimal impact on ratepayer electricity usage, when compared to other factors being reviewed in this case. Staff proposes to shift recovery of the revenue requirement from customer charges to delivery charges. If bills for some customers rise, then bills for others would decline. This would be a zero sum game from a revenue standpoint. (ICC Staff Exhibit 6.0 Corrected, 41-42; ICC Staff Exhibit 17.0 Corrected, p. 32)

In support of its proposal, Staff relies upon Rider 31, as setting precedent for recovery of environmental costs in delivery rates. ComEd's existing Rider 31, Decommissioning Expense Adjustment Clause, recovers nuclear decommissioning costs through a rider that "is applicable to each and every kilowatt-hour (kWh) of electricity delivered or sold at retail in the Company's service area, including, but not limited to, sales by the Company to tariffed services retail customers, sales by the Company to retail customers pursuant to special contracts or other negotiated arrangements, sales by alternative retail suppliers, and sales by an electric utility other than the Company… ." (ILL. C.C. No. 4, 7th Revised Sheet No. 95.09.4 (Cancelling 6th Revised Sheet No. 95.09.4)) Staff avers that this is a clear example of ComEd recovering an environmental cost associated with electric generation from the delivery component of ratepayer bills. (ICC Staff Exhibit 17.0 Corrected, pp. 30-31)

Staff avers that its proposal is more reasonable than the two alternatives proffered by ComEd. Staff finds ComEd's proposals to be problematic. The first alternative is to incorporate these charges into the cost of power received through the auctions. The second alternative is to do nothing at all.

Staff finds that incorporating environmental costs into auction power prices is problematic because environmental costs may arise not just for power received through the auction process, but also for unbundled power purchased from a Retail Electric Supplier ("RES"). If environmental costs were only reflected in power received through the auction, the relative cost of bundled power could rise and shift demand to RES-supplied power, regardless of the relative environmental impacts. (ICC Staff Exhibit 17.0 Corrected, p. 30)

The second alternative -- doing nothing -- is most problematic of all. Staff refers to a statement from the U.S. Environmental Protection Agency, that outlines the problem as follows:

> Rising global temperatures are expected to raise sea level, and change precipitation and other local climate conditions. Changing regional climate could alter forests, crop yields, and water supplies. It could also affect human health, animals, and many types of ecosystems. Deserts may expand into existing rangelands, and features of some of our National Parks may be permanently altered. http://yosemite.epa.gov/OAR/globalwarming.nsf/content/Impacts.html.

(ICC Staff Exhibit 17.0 Corrected, p. 30)

4. Rider ECR

<u>Staff's Position</u>

Staff witness Ebrey testified that she supports ComEd's proposal to recover manufactured gas plant ("MGP") remediation costs (also known as "coal tar" costs) through Rider ECR rather than through base rates. (ICC Staff Exhibit 2.0, p. 32) However, Ms. Ebrey disagreed with ComEd's proposal to recover internal Company costs and other costs in addition to coal tar costs through Rider ECR rather than through base rates. (*Id.*) With respect to these concerns, Ms. Ebrey proposed (1) the appropriate language changes to Rider ECR, (2) an adjustment to include the internal Company costs in the Company's test year operating expenses, and (3) language consistent with that in other utilities' coal tar riders relating to costs associated with former MGP sites, costs paid to outside vendors, insurance recoveries, the measurement period for costs and recoveries, the formula for the ECR charge, provisions for mid-year revisions of the ECR charge, annual reconciliation proceedings, and the filing date and effective date of ECR charge revisions. (ICC Staff Exhibit 2.0, pp. 30-39)

Staff noted in its Initial Brief that ComEd (1) indicated that any costs excluded from Rider ECR should be added back to the test year jurisdictional operating expenses (ComEd Ex. 19.0 Revised, pp. 62-63) and (2) accepted some of the proposed revisions to Rider ECR and rejected others. (Staff IB, p. 100) Further, Staff stated that ComEd accepted the following revisions proposed by Staff witness Ebrey:

1. Exclusion of internal wages and salaries. However, the Company does not address the exclusion of payments to affiliates in its rebuttal testimony. (ICC Staff Exhibit 2.0, pp. 35 – 37). Ms. Ebrey testified that she continues to propose that language change in Rider ECR. (ICC Staff Exhibit 13.0, Attachment C)

2. Revisions of ECR Adjustment between annual calculations,

3. Prudence review and annual reconciliation process,

4. Exclusion of land acquisition costs , and

5. Ordered Reconciliation Factor. (*Id.,* pp. 100, 102)

However, Staff added that ComEd rejected revisions proposed by Staff witness Ebrey relating to the exclusion of non-MGP related costs, the calendar year reconciliation cycle, and the inclusion of all insurance recoveries. (Id.) Staff accepted the January 2, 2007 effective date of the initial Rider ECR as proposed by ComEd but noted that future annual adjustments to the ECR charge should be at an effective date of January 1 each year (ICC Staff Exhibit 13.0, p. 36)

In her rebuttal testimony, Staff witness Ebrey explained that information provided by the Company calls into question the recoverability of the specific non-coal tar costs. She stated that since ComEd has not shown these costs to be reasonable, prudently incurred and related to its delivery service business, Ms. Ebrey cannot recommend they be recovered through either Rider ECR or base rates. (ICC Staff Exhibit 13.0, pp. 30-31) While ComEd offered testimony discussing the volatility of the non-MGP costs in its attempt to draw a favorable comparison between MGP and non-MGP environmental costs, Staff argued the ComEd's own witness refuted such testimony by confirming that other costs of similar volatility are recovered through base rates. (Staff IB, p. 101) Further, Staff noted that while ComEd attempted to graphically show that both MGP and non-MGP costs are similarly volatile (ComEd Exhibit 44.0, Attachment 1), the Company witnesses admitted during cross-examination that if the scale used for both graphs had been the same, the comparable volatility would be drastically different. (*Id.*) Thus, Staff argued that the facts demonstrate that non-MGP costs are much less volatile than MGP costs. (*Id.*)

In its Initial Brief, Staff stated that while ComEd uses the generic coal tar order as its basis for proposing recovery of environmental costs through Rider ECR in the instant proceeding, Company witness Crumrine agreed that, based on his definition of non-MGP costs, the generic coal tar order does not address those types of costs. (Staff IB, p. 102)

Regarding the calendar year reconciliation cycle, Ms. Ebrey noted that ComEd has not shown why it should be given preferential treatment for a September 30 reconciliation period. Ms. Ebrey continues to propose a December 31 reconciliation period consistent with that used by other utilities whose annual reporting period is a calendar year. (ICC Staff Exhibit 13.0, p. 36) In its Initial Brief, Staff argued that ComEd witness Crumrine contradicted the Company's claim that an annual reconciliation as of September 30th would avoid the possible need to increase staffing when he testified that he had not quantified the claim for the need for increased staffing due to a year-end reconciliation. (Staff IB, p. 102)

Regarding insurance settlements, Ms. Ebrey testified that since ComEd is currently in negotiations with its insurance carriers, it is reasonable to assume that some sort of settlement will be reached in the future. (ICC Staff Exhibit 13.0, p. 37) She stated that any benefits from insurance recoveries should be realized by the parties who have borne the costs related to those recoveries, regardless of when the funds are received. (*Id.*) Ms. Ebrey added that since it is doubtful that the settlement amount will be directly relatable to specific costs incurred and would more likely be related to the Company's liability at all of its MGP sites, she proposes that at the time of any insurance recoveries, the Company would file a revised Rider ECR resetting the rate to zero. (*Id.*) She testified that the insurance recoveries should then be used to cover any on-going remediation costs at the Company's MGP sites with interest being credited annually to the unexpended insurance proceeds at ComEd's after tax cost of capital from this rate case, to be updated at the time of subsequent rate cases. (*Id.*, pp. 37-38) It is Ms. Ebrey's position that once the insurance recoveries (plus interest) have been depleted to cover on-going remediation costs, Rider ECR could be revised based on the formula in the tariff. (*Id.*)

5. Rider AC7

Staff's Position

Staff does not object to ComEd's proposed Rider AC7 – Residential Air Conditioner Load Cycling Program 2007. (ICC Staff Exhibit 6.0, pp. 51-52) Rider AC7 offers residential customers a monthly discount during the Summer months in compensation for installing direct load controllers on their air conditioners. The load controllers mitigate peak demands, thereby reducing ComEd's overall capacity needs and costs. (*Id.*) ComEd is proposing to maintain the current rate of compensation to customers, which increases its costs by $1,168,961. Lowering the compensation to customers increases the potential that participation in the program will fluctuate. Staff finds value in maintaining participation in demand-side programs and, therefore, finds it reasonable to maintain the rates at current levels.

6. Rider CLR7

Staff's Position

Staff does not object to ComEd's proposed Rider CLR7 – Capacity-Based Load Response and System Reliability Program 2007. (ICC Staff Exhibit 6.0, pp. 45-46) ComEd proposes two new riders, one of which is Rider CLR7, to provide customers service options consistent with the auction process for bundled service and PJM-based energy and capacity credits for interruptible service. Rider CLR7 is consistent with ComEd's procurement of energy through an auction process, which will commence in 2007. (ICC Staff Exhibit 6.0, p. 45)

7. Elimination of Riders ISS, 13, 26, 27, 30, 32

Staff's Position

Staff does not object to ComEd's proposal to eliminate six riders. (ICC Staff Exhibit 6.0, pp.45-46) The riders ComEd proposes to eliminate are: Rider ISS – Interim Supply Service; Rider 13 – Governmental Pumping Service, Rider 26 – Interruptible Service; Rider 27 – Displacement of Self Generation; Rider 30 – Interruptible/Curtailable Service; and Rider 32 – Curtailable Service Cooperative. Staff finds that the elimination of these services is consistent with ComEd's move toward energy procurement through an auction process. Moreover, maintaining these riders would be costly given the aforementioned change. (ICC Staff Exhibit 6.0, p. 45)

9. Rider DE

Staff's Position

Staff does not object to ComEd's proposed Rider DE – Distribution system Extensions. (ICC Staff Exhibit 6.0, p. 53) Rider DE determines the charges an individual customer will pay ComEd to extend its distribution system to provide standard electric service to that customer. (Rider DE, ComEd Ex. 10.0, Sched. E2, ILL. C.C. No. 4, Orig. Sht. No. 434). Staff finds the rider to be reasonable. (ICC Staff Exhibit 6.0, p. 53)

10. Rider NS

a. Reserved Capacity Storage

Staff's Position

Staff no longer takes issue with ComEd's proposed Rider NS regarding language that would allow ComEd to charge costs in addition to those stated in the tariffed rates. In his direct testimony, Staff Witness Hanson identified language in ComEd's proposed Rider NS that was vague and confusing and that could allow ComEd to double charge for transmission and distribution capacity. (ICC Staff Exhibit 7.0, p. 9) In its rebuttal testimony, ComEd modified its language in proposed Rider NS with respect to transmission capacity, ensuring that customers would not be double charged. (ComEd Ex. 24.0, pp. 21-11) Staff witness Hanson, in his rebuttal testimony, stated that the aforementioned changes to transmission capacity language and clarifications by ComEd with respect to distribution capacity satisfied his concerns. (ICC Staff Exhibit 18.0, p. 2)

d. Rider NS and Elimination of Rider 8

Staff's Position

Staff opposes the termination of Rider 8, but does not oppose ComEd's alternative position if Rider 8 is not terminated. If the Commission decides that ComEd should be allowed to terminate Rider 8, Staff recommends that ComEd and the customer agree upon a payment for termination, rather than ComEd's offer of a "one-time, one-year equivalent transition payment." (ComEd. Ex. 24.0, p. 27) A negotiated transition payment allows the current customer to agree upon a reasonable payment from ComEd in exchange for terminating that customer's service under Rider 8.

(1) Company Proposal

ComEd's primary proposal is to discontinue Rider 8 and provide a one-time transition payment to each existing Rider 8 customer as of the date of the order in this case. ComEd proposes that it will pay each Customer a transition payment equal to one year of credits that the customer would be entitled to receive under Rider 8. (ComEd. Exhibit 24.0, pp. 26-27) It is Staff's reading of ComEd's surrebuttal testimony that in the event the Commission does not eliminate Rider 8, ComEd proposes that the availability of Rider 8 be limited to only the existing Rider 8 customers, and that no new customers be allowed to take from Rider 8. (ComEd Ex. 41.0, pp. 18-19) ComEd also requests that in the event Rider 8 is not eliminated, that the Rider 8 credits be included in the revenue requirements. (ComEd Exhibit 24.0, pp. 26-27)

(2) Staff Opposition to ComEd's Primary Proposal

Staff opposes the proposals offered by ComEd. ComEd's primary proposal is to discontinue Rider 8 and provide a one-time transition payment to each existing Rider 8 customer as of the date of the order in this case. Staff argues that customers who purchased transformers based on the expectation of being compensated for that cost through Rider 8 will no longer receive compensation. In addition, this proposal would result in an increase in the electric bills of most of the 225 Rider 8 customers. (ICC Staff Exhibit 8.0, pp. 12-13)

Staff explains that the one time compensation ComEd is offering is equal to one year's worth of credits is insufficient when compared to the amount the customer spent on the purchase of a transformer. A transformer's life expectancy is thirty years. Some of the Rider 8 customers have installed transformers within the last ten years. Staff asserts that a one-time payment equal to one year's worth of credit would not approach the total amount of credit a customer expected to receive over the life of that transformer when it purchased the transformer. (ICC Staff Exhibit 19.0, pp. 6-7) ComEd's proposal amounts to a rules change in the middle of a game – which is both unfair and unreasonable.

In the event the Commission decides to allow ComEd to terminate Rider 8, Staff recommends that the Commission reject ComEd's proposed termination payment of a "one-time, one-year equivalent transition payment." (ComEd. Ex. 24.0, p. 27) In place of ComEd's proposal, Staff recommends that ComEd and the customer negotiate a compensation amount to the customer for terminating the provision of Rider 8. (ICC Staff Exhibit 19.0, pp. 6 and 8) The purpose of the negotiated transition payment is to allow the current customer to agree upon an amount which they view to be a reasonable compensation for the value and expected life of the transformer, or transformers, the customer had purchased. (*Id*. at 6-7)

Staff proposed following language be inserted into Rider 8, if ComEd is allowed to terminate Rider 8, and Staff's proposal for a negotiated transition payment is accepted.

(3) ComEd's Alternative Proposal

Staff explained that it does not oppose ComEd's alternative proposal (i.e., in the event that Rider 8 is not eliminated by the Commission), because Staff understands this proposal to allow all customers from Rider 8 to continue receiving Rider 8 credits and will allow the customer to determine if and when they should stop taking of Rider 8. (ComEd Exhibit. 41.0, pp. 18-19)

11. Rider POG

Staff's Position

Staff opposes ComEd's proposal to implement Rider POG – Parallel Operation of Retail Customer Generating Facilities and eliminate the current Rider 4, but will withdraw its opposition if ComEd agrees to two additions. Staff also points out that there is a tangential federal reporting issue, which Staff is not addressing at this time, but will address when ComEd makes its annual filing of avoided costs, in compliance with 83 Illinois Administrative Code Part 430 and furtherance of 18 CFR §292(d).

a. Background

Staff provides the following background information. Through the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Congress encourages cogeneration and small plant power production. Federal rules implementing PURPA require an electric utility to purchase energy and capacity made available by a qualifying facility[10] ("QF").

[10] "Qualifying facility" means a cogeneration facility or a small power production facility which meets the (continued…)

(18 CFR §292.303(a)) The rates and terms of the purchases from the QF must comply with Section 292, or can be negotiated by the electric utility and QF. (18 CFR §292.301) The issue at hand relates to the former.

The rate of compensation to the QF must comply with Section 292.304. Section 292.304 makes clear that one of the factors affecting rates for purchases is avoided costs. (18 CFR §292.304(e)) An electric utility is to provide to the state regulatory authority "the estimated avoided cost on the electric utility's system, solely with respect to the energy component, for various levels of purchases from qualifying facilities." (18 CFR §292.302(b)(1)) The provision of the avoided cost data to the Commission is facilitated through Section 430.50 of the Commission's rules. (83 Ill. Admin. Code §430.50) Section 430.50 directs Illinois electric utilities to file the information described in Section 292.302(b) "not less than every two years", in June. (ICC Staff Exhibit 8.0, p. 8; *see also* ComEd Ex. 9.0, pp. 26-27; ComEd Ex. 40.0, pp.76-77)

The current rider under which ComEd compensates QFs is Rider 4. The compensation, or rates, set forth in Rider 4 are for a one year period. (Rider 4, ComEd Ex. 10.1, ILL. C.C. No. 4, 4th Rev. Sht. No. 64.10). ComEd has been annually updating the customer compensation in Rider 4, to coincide with any annual changes in avoided costs. (ICC Staff Exhibit 8.0, p. 12)

In this tariff filling, ComEd proposes to replace existing Rider 4 with Rider POG. (ComEd Ex. 9.0 Corrected, pp. 26-27; ComEd Ex. 10.14, p. 4) Both Rider 4 and Rider POG include terms and conditions for ComEd's purchase of excess electricity generated by a QF, or customer. Rider POG describes four services under which ComEd would purchase excess electricity (Options A – D), and only under Options C and D is the QF compensated. (Rider POG, ComEd Ex. 10.1, ILL. C.C. No. 4, Orig. Sht. No. 458-59) A QF is compensated either through Nodal Compensation or Zonal Compensation. (*Id*. at Sht. No. 459) Both methods of compensation have replaced the express rate per kW-hour, that is based on avoided costs, with a formula that is based on the PJM Real Time Generator nodal Locational Marginal Prices ("LMP") or PJM real-time, LMP for the ComEd zone ("PJM data").

Staff's concern is that ComEd intends to no longer state a specific amount of compensation, or rate, in its new rider. (ICC Staff Exhibit 19.0, pp. 2-5) The current rider -- Rider 4 -- expressly states the rate at which a QF will be compensated for selling its excess electricity to ComEd, whereas, in contrast, Rider POG only describes the factors it would use to calculate the rate ComEd would pay the QF.

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criteria for qualification set forth in Subpart B of 18 CFR §292 and which enters into an agreement to sell electricity to a public utility.

b. Rider POG Should Expressly State the Rate ComEd Would Pay a Qualifying Facility

Staff recommends two modifications to Rider POG. First, Staff recommends that language be added to Rider POG recognizing that Part 430 grants QFs the ability to negotiate electric rates or capacity rates. This language is reflected in ComEd Exhibit 49.0, which was filed post-hearing. Staff states that it has no objection to the additional language that is reflected in Exhibit 49.0. Thus, the only issue regarding Rider POG is Staff's second proposal, which is that Rider POG should offer an additional standard rate for Options C and D; rates that expressly state the rate at which ComEd would compensate the QF.

Staff still contends that the failure to openly state a level of compensation in Rider POG adds uncertainty to the market, and that uncertainty is contrary to Congress' intention to conserve energy by using the excess electricity generated by independent generating facilities. (ICC Staff Exhibit 19.0, p. 3) Staff posits that certainty can be provided by adding adopting its position.

Staff explains that the intent behind PURPA was to encourage cogeneration and small plant power production. For that intent, Staff relies upon a FERC Notice of Proposed Rulemaking, issued at the time FERC was initiating its rules governing QFs, in which the FERC stated "Section 210(a) [of PURPA] requires the [FERC] to prescribe rules 'as it determines necessary *to encourage cogeneration and small power production* . . . which rules [shall] require electric utilities to offer to sell electric energy to and purchase electric energy from qualifying cogeneration and small power production facilities,'" and "that section 210(a) of PURPA 'provides a general mandate for the [FERC] to *prescribe rules necessary to encourage cogeneration and small power production* (emphasis added).'" (*Eligibility, Rates and Exemptions for Qualifying and Utility-Owned Geothermal Small Power Production Facilities*; Notice of Proposed Rulemaking, Docket No. RM 81-2, 45 FR 74934 (Nov. 13, 1980)) Staff asserts that the lack of a definite rate of compensation to the QF in Rider POG is not consistent with Congressional intent.

Staff witness Linkenback also explains that the compensation described in Rider POG does not provide sufficient incentive for small generators or co-generators to become a QF or for existing QFs to continue selling their excess generation. (ICC Staff Exhibit 19.0, p. 4) Potential small power producers will likely be discouraged by the absence of a definite rate in proposed Rider POG and decide not to make the investment in generating equipment, which in turn would reduce the number of small power producers who choose to operate in ComEd's service territory. (*Id*.) Staff therefore argues QFs and potential QFs need to know what the compensation rates will be so they can determine their potential return and risk. And that this lack of information increases uncertainty in this area of power generation and deters companies from becoming a co-generator or a small power producer.

Staff proposes that language paralleling the fixed price offering in Rider 4 (ComEd. Exhibit 10.1, ILL. C.C. No. 4, 30th Revised Sheet No. 64) be inserted into Rider POG.

c. Implementation of Staff Proposal

In the event that the Commission adopts Staff's position, and requires ComEd to expressly state a rate of compensation as an alternative to the Nodal and Zonal Compensations, Staff explains that such rate of compensation would still be tied to the avoided costs in ComEd's Part 430 filing. In June, ComEd is to submit avoided cost information in compliance with Part 430. Staff explains that, traditionally, ComEd changes the rate of compensation in Rider 4 based on that information. (ICC Staff Exhibit 8.0, p. 12) Rider 4 is to remain in place until Rider POG starts on January 2, 2007. (ICC Staff Exhibit 8.0, p. 7, lines 145-150)

Thus, Staff recommends that the rate of compensation that will be stated in Rider 4, for the second half of 2006, be transferred into Rider POG. Staff argues that this would make sense, since Staff is proposing to include in Rider POG the same compensation language that is in Rider 4. On a going forward basis, Staff proffers, Rider POG can be updated annually based on its Part 430 filing, similar to Rider 4.

In its initial brief, Staff points out that the approval of Rider POG should not be considered a review and approval of an alternative method of estimating avoided cost data as prescribed in 18 CFR §292.302(d). Staff explains that Federal Rules require a state commission to notify the FERC if the data used to estimate avoided costs is different than what is prescribed by Section 292.302(b)(1). (18 CFR §292.302(d)(2)) Section 292.302(d)(1) states:

> <u>After public notice in the area served by the electric utility, and after opportunity for public comment, any State regulatory authority may require</u> (with respect to any electric utility over which it has ratemaking authority), or any non-regulated electric may provide, <u>data different than those which are otherwise required by this section if it determines that avoided costs can be derived from such data.</u>

(18 CFR §292.302(d)(1)) (emphasis added). Staff interprets "data", in the preceding quote, is the same information Illinois electric utilities provide the Commission in June pursuant to Section 430.50. This is cost data has been used by ComEd to determine the compensation to QFs and which ComEd seeks to change in Rider POG. (ICC Staff Exhibit 8.0, p. 9) Therefore, Staff is anticipating that ComEd will be changing its method of calculating future avoided energy costs in its annual Part 430 filing, although Staff cannot be sure what method ComEd will use until ComEd submits that filing. (§430.50(a)(1)(B)(i)) Thus, Staff argues that the issue is not ripe at this time, since ComEd has not formally explained how it will be calculating its avoided costs in

compliance with Part 430. Moreover, ComEd did not request this proceeding address this federal notification requirement. Thus, Staff recommends that the Commission expressly state in the order that approval of Rider POG does not constitute review and approval of an alternative method of estimating avoided cost data as prescribed under federal law.

12. Rider GCB7

Staff's Position

Staff does not object to ComEd's proposed Rider GCB7 -- Governmental Consolidated Billing 2007, which replaces existing Rider GCB -- Governmental Consolidated Billing. (ICC Staff Exhibit 7.0, pp. 7-8)

13. Rider QSW

Staff's Position

Staff does not object to Rider QSW -- Qualified Solid Waste Energy Facility Purchases, which replaces existing Rider 3. Rider QSW sets forth the conditions by which ComEd purchases electric power from retail customers who have been found by the Commission to be Qualified Solid Waste Energy Facilities under Section 8-403.1 of the Public Utilities Act. (ICC Staff Exhibit 7.0, pp. 12-13)

16. Rider ML

Staff's Position

Staff does not object to Rider ML – Meter-Related Facilities Lease. Staff reviewed the accuracy of the monthly rental charges for various meter classes and found no reason to contest the rates proposed for Rider ML. (ICC Staff Exhibit 8.0, p. 18) In rebuttal testimony, Staff witness Schlaf was concerned that CUB's real time pricing proposal may result in the overstating of usage. Dr. Schlaf's concern was based on ComEd's response to Staff Data Request RDL 7.01, which was received shortly before the filing of Staff rebuttal testimony and therefore was not incorporated into Staff's rebuttal testimony. (ICC Staff Exhibit 20.0, p. 9) ComEd subsequently reduced the meter lease charge applicable to residential customers. (ComEd Ex. 46.0, p. 31) The new charge is $5.36 per customer per month. Staff does not object to the revised charge. (ICC Staff Exhibit 24.0, p. 2)

17. Rider Resale

b. Unresolved Issues

Staff's Position

Staff witness Schlaf expressed concerns with respect to ComEd's proposed Rider Resale. (ICC Staff Exhibit 20.0, p. 15) First, he stated that it was not apparent why a building owner could resell electricity without first obtaining an Alternative Retail Electric Supplier ("ARES") certificate from the Commission. *(Id.)* Staff also argued in its Initial Brief that the new language contained in Rider Resale might be interpreted to broaden eligibility beyond the statutory provision defining "retail customer" to include an entity which is receiving electric service from a public utility and was engaged in the practice of resale and redistribution of such electricity within a building prior to January 2, 1957. (Staff IB, p. 120; *see also* 220 ILCS 5/16-102) Second, Dr. Schlaf noted that even if a building owner could resell electricity, the proposed modifications would permit certain building owners to charge their tenants anything that they wished for the electricity they purchase from ComEd, as long as the price for the resold electricity is stated in a lease or agreement. (*Id.*) He noted that these modifications would create the possibility that electric rates and charges could vary considerably among the tenants in the same building. (*Id.*)

Notwithstanding the above-stated concerns, Staff stated in its Initial Brief that since it does not advocate requiring building owners that resell electricity to tenants within the buildings that they own to become certified as Alternative Retail Electric Suppliers, Staff does not object to the modifications to Rider Resale as expressed in ComEd witness' surrebuttal testimony. (Staff IB, p. 121)

19. Rate BES-RR

Staff's Position

Staff does not object to ComEd's proposed Rate BES-RR -- Basic Electric Service-Railroad, which replaces two existing special contracts for rail service providers. (ICC Staff Exhibit 7.0, pp. 11-12) ComEd will be acquiring energy from third party providers beginning in 2007. Thus, tying the energy cost of the service to the auction process and serving the customer under delivery services tariffs appears to be appropriate. (*Id.*)

20. General Terms and Conditions

Staff's Position

Staff does not object to ComEd's proposed increases in several charges contained in the General Terms and Conditions, but does take issue with the elimination of an energy audit service. (ICC Staff Exhibit 18.0, p. 4)

ComEd offers an energy audit service to residential customers for $15. In response to Staff's opposition, ComEd proposed that customers use an "Energy Advisor do-it-yourself energy audit" offered via the internet. (ComEd Ex. 24.0, p. 28) ComEd modified its website so customers can be transferred, or linked, to the Energy Advisor website. (*See* ComEd Exhibit 24.5, showing the ComEd and Energy Audit web pages) Staff witness Hanson reviewed the Energy Audit website and found that it is not identical to the service included in the tariff. (ICC Staff Exhibit 18.0, p. 3) Moreover, Staff is concerned that lower income customers may not have access to the internet to take advantage of the replacement program ComEd has proposed. (*Id*.).

In surrebuttal testimony, ComEd proposed that this issue be addressed in the upcoming rulemaking regarding energy efficiency. (ComEd Exhibit 41.0, p. 21) Staff does not oppose that proposal. Staff will withdraw its opposition to the elimination of the energy audit service and will address the issue in the upcoming energy efficiency rulemaking. (Tr. 1169-70)

22. Proposed Change In Definition of Maximum kW Delivered

Staff's Position

Staff contests ComEd's proposal to change the time period for determining the maximum demands used to calculate the demand cost component of the bill for nonresidential ratepayers. ComEd proposes to use the maximum demand incurred by each individual ratepayer during a month, regardless of the time of day. (ComEd Ex. 9.0 Corrected, p. 45) Staff proposes that demand charge not be changed, and that demand charges for nonresidential ratepayers continue to be based on ComEd's peak period demands. In support of its position, Staff states that peak demand is best selected based on the usage of groups of ratepayers, not individual ratepayers. Moreover, the current method encourages ratepayers to shift their demands from the peak to off-peak periods of the distribution system.

Staff argues that ComEd is sending the wrong price signals to ratepayers. Staff points out that the distribution system (exclusive of customer-related costs), for the most part, is designed to serve groups of customers. What drives these costs, therefore, are not the demands of individual customers, but rather groups of customers. As an example, Staff explains that distribution lines at any moment may carry the demands of numerous customers, and that the collective demands of those customers may be expected to peak during times of peak demand. A ratepayer whose peak demand is at

3am should not cause a strain upon ComEd's distribution system capacity because the demands of other ratepayers, at that time, would be low. (ICC Staff Exhibit 6.0 Corrected, p. 50)

Staff proffers its position as being the more reasonable. Staff states that basing the demand component of a bill on ComEd's peak period demands is the more reasonable position. The peak period reflects that part of the day when demands on ComEd's distribution system are greatest. This also signals to ratepayers that their demands during peak periods are important factors in determining overall costs on the distribution system. At the same time, it will signal to ratepayers that off-peak demands are less costly from a system standpoint. These signals will encourage ratepayers to shift their demands from the peak to off-peak periods and, thereby, promote efficient use of the distribution system. (ICC Staff Exhibit 6.0 Corrected, pp. 50-51)

Staff also relies upon the principle of rate continuity. Current tariffs, for both delivery and bundled services, base demand charge calculations solely on demands during the peak period. Some ratepayers have established a pattern of behavior, or installed equipment, to take advantage of the current definitions. ComEd's proposal would require ratepayers to change their demands to a new set of definitions, and Staff asserts that that change could prove costly for those ratepayers. (ICC Staff Exhibit 6.0 Corrected, p. 51)

26. Supply Administration Charge

<u>Staff's Position</u>

Staff proposes that the Supply Administration Charge ("SAC") be recovered on a usage basis from bundled customers. The costs recovered through this charge pertain to the administration of the supply function for bundled service customers. (ComEd Ex. 6.0 Corrected, p. 47) Recovering the SAC through a usage charge is preferable to ComEd's proposal because the level of SAC costs bear a closer relationship to usage than to the number of customers (which is ComEd's proposal) and is more reasonable than ComEd's proposal. Given this positive correlation between costs and usage, SACs within individual auctions should be based on bundled usage levels, and not number of customers. (ICC Staff Ex. 6.0 Corrected, pp. 48-49) Staff points out that ComEd witness Crumrine may believe that SAC costs do not vary with the number of customers, based on a quote from his rebuttal testimony.

Staff also claims that ComEd's proposal is internally inconsistent. Staff explains that ComEd allocates SAC costs between the BES auctions on a usage basis and within the auctions on a customer basis. Staff argues that this is illogical, and that Staff's proposal, to base SAC charges on usage throughout the allocation process, is clearly more reasonable. (ICC Staff Exhibit 17.0 Corrected, p. 36)

27. Real Time Pricing Meters and Energy Smart Pricing Plan

Staff's Position

Staff witness Schlaf recommended that the Commission reject CUB's Real Time Pricing ("RTP") proposal. (ICC Staff Exhibit 20.0, p. 6) Although a RTP program has potential benefits, Dr. Schlaf identified certain issues with CUB's proposal and recommended the Commission direct ComEd to undertake a two-year pilot program designed to obtain certain data necessary to address those issues.

Dr. Schlaf explained that real-time pricing programs are a form of demand response ("DR"). (*Id.*, p. 4) He stated that DR programs, which include energy efficiency programs and load reduction programs, encompass a wide range of policies that are designed to encourage customers to use energy more efficiently by, for example, shifting their consumption from periods when wholesale prices are relatively high to lower-priced periods. (*Id.*) Dr. Schlaf noted that implementation of DR programs could result in several societal benefits, potentially including a reduction in price volatility, improved reliability, and improvements in the environment. (*Id.*)

Further, Dr. Schlaf testified that the key to achieving such benefits lies in customers taking action to change their normal consumption patterns in response to market-prices. He stated that measuring customer consumption, however, requires the use of Interval Demand Register ("IDR") meters, which are typically more expensive than watt-hour meters. Dr. Schlaf testified that currently, incremental metering costs for switching from watt-hour meters to IDR meters are about $100 annually for ComEd residential customers. He concluded that since the $100 annual cost is a large fraction (approximately one-seventh) of an average residential customer's bill, few customers would voluntarily pay for an IDR meter in order to take an RTP rate. (*Id.*, pp. 4-5)

After evaluating CUB's proposal, Dr. Schlaf stated that several benefits could flow from CUB's proposal. He noted, however, that quantification of these potential benefits, particularly the benefits to non-participants that might be achieved through lower wholesale prices and improvement in reliability, could be difficult. (*Id.*, pp. 5-6)

Dr. Schlaf testified that the price benefits available to non-participating customers could occur through reductions in bids offered by the bidders in the upcoming auctions. (ICC Staff Exhibit 22.0 (Corrected), p. 14) The magnitude of the potential reductions is dependent on the ability of residential RTP customers to affect wholesale prices through demand response. Staff questioned this ability given the size of the wholesale market in which ComEd obtains supply, the PJM Interconnection, a market that comprises about 135,000 MW of demand and a generating capacity of 160,000 MW. Dr. Schlaf calculated that causing a reduction of an amount as small as 1% in the overall demand of the PJM market would take the combined actions of around one million ComEd residential customers reducing their consumption at the appropriate time. (*Id.*, pp. 20-21) In its Initial Brief, Staff noted that the CUB proposal envisions a customer participation rate of approximately one hundred thousand customers. (Staff IB, p. 130) Dr. Schlaf also discussed the costs associated with the CUB proposal, which include (1) metering costs; (2) promotional costs; (3) administrative costs; (4) costs associated with monitoring real-time prices; and (5) a "loss of amenity" due to a reduction in lighting or cooling levels. (ICC Staff Exhibit 22.0 (Corrected), pp. 19-20) He noted that these costs, especially the metering, promotional, and administrative costs, can probably be estimated fairly accurately. (*Id.*, p. 20)

Dr. Schlaf concluded, in view of the concerns expressed above, that the Commission should not adopt the CUB proposal at this time, and further stated that he would be reluctant to advocate a program in which all residential customers would pay for the costs of such program but only a small number of customers would benefit. (ICC Staff Exhibit 20.0, p. 6) Instead, Dr. Schlaf proposed that the Commission direct ComEd to undertake a two-year pilot program to determine whether evidence could be obtained that would show that the potential benefits of the CUB proposal would exceed the costs imposed on the customers that do not participate in the RTP program. (*Id.*, p. 7) Dr. Schlaf testified that an analysis of the type he proposed is needed in order to compare the costs and benefits of implementing the CUB proposal because very little data exists regarding the extent to which residential customers might respond to real-time prices. (ICC Staff Exhibit 22.0, (Corrected) p. 24)

Although Dr. Schlaf acknowledged the existing pilot program conducted by Community Energy Cooperative ("CEC") in partnership with ComEd (with an enrollment of approximately 1,500 customers), that program does not address the key question of whether a large expansion of RTP, in the manner proposed by CUB, would be likely to produce net benefits for all customers. (ICC Staff Exhibit 22.0 (Corrected),. pp. 19-22) Thus, he concluded that the results of the program, while perhaps indicative of the potential savings available to participating customers, cannot be relied upon to assure the Commission that all residential customers would benefit from the CUB proposal.

Dr. Schlaf stated that conducting a net benefits calculation would require a comparison of the sum of the identifiable costs that would be imposed on all customers with the sum of the potential benefits. In its Initial Brief, Staff noted that the Commission would be required to make such an assessment if Senate Bill 1705, which was passed on April 6, 2006, by both houses of the General Assembly without a single dissenting vote, is signed by the Governor. (S. 1705, 94th Illinois General Assembly, (2006))

Dr. Schlaf recommended that 2,000 customers participate in his proposed pilot program because it would provide reliable information about potential demand responsive of residential customers without unduly burdening non-participating customers. (ICC Staff Exhibit 22. 0 (Corrected), p. 25) Prior to beginning the program, Dr. Schlaf stated that the 2,000 participants would be provided with IDR meters so that their normal consumption patterns could be recorded; however, the participants would take service under the standard bundled rate during the first year. During the second year, he noted that the same group of customers would be placed on the RTP rate, and changes from the customers' typical consumption patterns would be identified. (*Id.*, p. 27)

Dr. Schlaf testified that the next step in determining the potential benefit of the RTP program would be to estimate the number of customers that would be willing to move to an RTP rate. He stated that incorporating the costs of equipping customers with IDR meters and comparing the costs with estimated level of net benefits would conclude the analysis. Staff witness Schlaf recommended that the analysis be conducted by a third-party, with assistance from ComEd, CUB, Staff, and other interested parties. (*Id.*, p. 596-601) Therefore, in its Initial Brief, Staff recommended that the Commission accepts its RTP pilot program and reject CUB's proposal. (Staff IB, p. 133)

28. Distribution Loss Factors

Staff's Position

Staff found the distribution loss factors in Rate RDS – Retail Delivery Service – were reasonable. (ICC Staff Exhibit 8.0, p. 19) Rate RDS provides the rates for ComEd to deliver power and energy to customers who have chosen to purchase all or a portion of their power and energy from suppliers other than ComEd. Staff witness Linkenback based his determination on his review of the technical data submitted by ComEd. Staff determined that the procedure used by ComEd to calculate the distribution loss factors was correct.

29. Replacement of Rider 28 with Rider LGC

Staff's Position

Staff does not object to replacing Rider 28 with Rider LGC – Local Government Compliance Adjustment. Staff witness Hanson examined the differences between the two riders and expressed concern that some of the language contained in Rider LGC was not in Rider 28 and was unduly vague. (ICC Staff Exhibit 7.0, p. 7) In its rebuttal testimony, ComEd clarified certain aspects of how it will implement Rider 28 and how the language in the new tariff is unchanged from Rider 28. (ComEd Ex. 24.0, p. 16) Staff witness Hanson, in his rebuttal testimony, stated that ComEd's clarifications had addressed his concerns. (ICC Staff Ex. 18.0, p. 2)

IV. CUSTOMER CHOICE AND RETAIL COMPETITION ISSUES

A. Clarification of Tariffs for Post-Transition Period

Staff's Position

In responding to the CES recommendation that ComEd modify or clarify the tariffs that were recently approved by the Commission in Docket No. 05-0159, Staff witness Schlaf testified that CES' comments are understandable since the new tariffs will have unfamiliar names, terms and conditions, and some current tariffs will not even exist after 2006. Dr. Schlaf recommended, however, that the Commission not require ComEd to modify the new tariffs for two reasons. First, he noted that over time the new tariffs will become familiar. Second, Dr. Schlaf testified that ComEd committed to modifying its RES Handbook and Customer Handbook, which should minimize customer confusion about the new tariffs. (ICC Staff Exhibit 20.0, p. 14)

B. General Account Agency

Staff's Position

Staff witness Schlaf recommended that the Commission reject CES' recommendation that ComEd should allow customers: (1) to be able to choose the level of authority that General Account Agents ("GAA") should be given and (2) to designate multiple GAAs. (ICC Staff Exhibit 13.0, pp. 12-13) He noted that ComEd has cited operational reasons for not supporting the recommendation and has expressed concerns that an agent could resell ComEd's service without first receiving certification as an Alternative Retail Electric Supplier. (*Id.*) Dr. Schlaf agreed with ComEd's suggestion that discussion of GAA issues would be more appropriate in an informal workshop setting, rather than in the instant proceeding. (ICC Staff Exhibit 20.0, p. 13)

C. Electronic Data Interchange

Staff's Position

Staff witness Schlaf recommended that the Commission reject CES' recommendation that improvements be made to Electronic Data Interchange ("EDI") methodologies. (ICC Staff Exhibit 20.0, p. 14) He stated that the Commission has generally viewed the technical details of EDI transactions as matters that utilities and RESs should attempt to resolve informally. (*Id.*, p. 13) Utilities and RESs have established working groups to discuss EDI issues. (*Id.*) Thus, Dr. Schlaf concluded that the CES recommendations should first be discussed through the workshop process and should only be brought to the Commission's attention for resolution if the issues cannot be resolved informally. (*Id.*, pp. 13-14)

F. Utility Consolidated Billing with Purchase of Receivables

Staff's Position

Staff witness Schlaf recommended that the Commission reject CES' proposed Utility Consolidated Billing ("UCB") service with a Purchase of Receivables ("POR") feature. (ICC Staff Exhibit 20.0, pp. 10-12) He noted that ComEd has argued that (1) it does not believe that the CES has demonstrated a persuasive enough business case to cause ComEd to incur the expenses that would be required to modify its billing systems to implement the proposal, and (2) it cannot be compelled to offer the service, since the UCB program would constitute a new utility service. (*Id.*))

> In its Initial Brief, Staff agreed with ComEd that ComEd cannot be compelled to offer the UCB program under Section 16-103(e) of the Public Utilities Act(the "Act") (220 ILCS 5/16-103). (Staff IB, pp. 137-138)

Staff argued that the UCB program is not a tariffed service required by Section 16-103 of the Act and it does not meet the definition of a competitive service under Section 16-102 of the Act (220 ILCS 5/102). While recognizing that the UCB program has the potential to interest RESs in serving smaller-use customers, Dr. Schlaf shared ComEd's concern that the cost of modifying its billing systems could be significant. (ICC Staff Exhibit 20.0, p. 11) Moreover, he was concerned that the POR feature of UCB might encourage RESs to market to customers that cannot meet their credit requirements because ComEd and its customers would be responsible for collecting delinquent payment from customers rather than RESs. (*Id.*) Finally, Dr. Schlaf stated that there is a possibility that Commission rules may have to be modified if a POR/UCB program were implemented. (*Id.*, pp. 11-12)

V. STAFF REPORTS ON COMED'S PERFORMANCE

A. Tree Trimming

Staff's Position

Although Staff is not requesting that the Commission make a specific finding in this rate case, or order ComEd to take specific actions, Staff has submitted testimony explaining that Staff has concerns regarding ComEd's tree trimming. Staff asserts that ComEd is not in compliance with National Electric Safety Code ("NESC") Rule 218, which the Commission has made a part of its Administrative Code Part 305. (ICC Staff Exhibit 9.0, pp. 6-7; ICC Staff Exhibit 10.0, Attachment 10.0, pp. 10-11) This is supported by testimony of Staff witness Spencer and *Staff's Assessment of ComEd's Reliability Report and Reliability Performance for 2004* ("Staff Report"). Staff notes that it has recommended to ComEd that the Company investigate its problem areas, take steps to correct those areas and prevent recurrence of the problems. (ICC Staff Exhibit

9.0, pp. 6-7).Staff stated that if ComEd is found to be still be out of compliance after the tree trimming inspections in 2006, Staff has assured the Commission that it will take the actions necessary to ensure ComEd's compliance with Commission rules governing tree trimming.

B. Reliability Performance

Staff's Position

Although Staff is not requesting that the Commission make a specific finding in this rate case, or order ComEd to take specific actions, Staff has submitted testimony explaining that Staff has concerns regarding ComEd's maintenance, its vegetation management, its operations of substation equipment and its customer satisfaction performance. Staff has already notified ComEd that it needs to improve its efficiency and economies of overall system maintenance and operation, and to inspect its substation equipment and make adjustments as necessary.

The basis of Staff's findings is *Staff's Assessment of ComEd's Reliability Report and Reliability Performance for 2004* ("Staff Report"). (ICC Staff Exhibit 10.0, Attachment 10.1) The Staff Report is prepared pursuant to 83 Illinois Administrative Code Part 411.140. The report is based on Staff's review of ComEd's 2004 annual reliability report and field inspections of trees, random circuits, worst circuits and substations that Staff conducted in 2005. The Staff Report culminates with *Potential Reliability Problems and Risks*. It is those problems and risks that Staff is emphasizing in this case.

1. Vegetation Management Needs Improvement

Staff's Position

Staff recommends that ComEd continue improving its vegetation management program. (ICC Staff Exhibit 10.0, p. 8) When asked if it would take more resources on ComEd's behalf to do that, Staff replied that it could take either more resources or reallocate existing resources or just perform the work more efficiently. (Tr., p. 1768) Staff notes in its Staff Report that it is unconvinced that ComEd has sustained a four-year trim cycle at a level of reasonable quality. (ICC Staff Exhibit 10.0, Attachment 10.1, p. 30; Tr., p. 1768) Furthermore, it is absurd that ComEd had no concept, in mid-2005, of the magnitude of money it would be spending in 2007 on its vegetation management activities. (ICC Staff Exhibit 10.0, Attachment 10.1, p. 26) This lack of control is another indication of the volatility of ComEd's current vegetation management program.

2. Substation Equipment

Staff's Position

Staff recommends that ComEd inspect insulating oil levels of substation equipment as appropriate and make adjustments as necessary. (ICC Staff Exhibit 10.0, p. 8) When asked about the implication of insufficient oil levels in substation equipment, Staff observed that especially in small oil volume devices, such as bushings of oil circuit breakers, a catastrophic failure could result. For example, it could cause an event, much like an explosion, that would take out the breaker and spread burning oil throughout the substation yard. (Tr., p. 1767)

3. Customer Satisfaction Performance

Staff's Position

While Staff and ComEd are in agreement that ComEd has improved customer satisfaction performance over the last few years (Tr., p. 1763), Staff notes, that since last year, ComEd is scoring in the neighborhood of other state utilities and even exceeded the scores of several other utilities in residential (but not commercial) customer satisfaction surveys. (ICC Staff Exhibit 10.0, Attachment 10.1, p. 7-8) Staff continues to recommend that ComEd continue its focus on improving customer service. (ICC Staff Exhibit 10.0, p. 8)

4. Maintenance Programs

Staff's Position

Adequate preventive and corrective maintenance programs, which include a well planned vegetation management program, are the most important factors to influence long-term customer reliability. Unfortunately, maintenance programs are one area where a company can cut spending quickly and have an immediate impact on short-term income statement performance with minimal impact on short-term reliability performance. (ICC Exhibit 10.0, Attachment 10.1, p. 28) Staff pointed out that ComEd needs to strive for and invest in greater efficiencies or reallocate its resources or increase spending. (Tr., p. 1770) In addition, ComEd has improved its efficiency on corrective maintenance work, at least on a short-term basis, with a smaller manpower budget.

Staff, however, remains concerned that if efficiency improvements should plateau and/or workforce levels decline too far and/or maintenance budgets are not adequate, then ComEd would have a strong incentive to cut back on the intensity of inspections in order to reduce the backlog of corrective maintenance work. Staff continues to encourage ComEd to improve efficiencies and economies of maintenance and operations. (ICC Staff Exhibit 10.0, Attachment 10.1, p. 28)

5. Worst Circuit Performance

Staff's Position

The poor performance of ComEd's worst-circuit in relation to the worst-circuit of other jurisdictional utilities for 2004 remains a matter of concern for Staff. (ICC Staff Exhibit 10.0, Attachment 10.1, p. 28)

C. Electric Metering

Staff's Position

Although Staff is not requesting that the Commission make a specific finding in this rate case, or order ComEd to take specific actions, Staff has submitted testimony explaining that Staff has concerns regarding ComEd's electric metering. Staff based its findings on the most recent electric metering audit it performed, in which Staff found ComEd's electric metering practices out of compliance with the Commission's electric metering rules in four specific areas. (ICC Staff Exhibit 11.0, pp. 2-3, and Schedule 11.1 – Letter to ComEd RE: Staff's 2005 Electric Meter Shop Inspection, pp. 1-2) In testimony, Staff reviewed five recommendations it provided ComEd in December 2005 that were intended to help the Company more fully comply with the Commission's rules. (ICC Staff Exhibit 11.0, Schedule 11.1, pp. 3-4) Of Staff's findings and recommendations, the need for ComEd to comply with 83 Illinois Administration Code 410.120(e) is the only issue meriting discussion in this proceeding. (ICC Staff Exhibit 11.0, Schedule 11.1, p. 1) Staff asserts that ComEd does not agree with Staff's finding concerning Subsection 410.120(e).

Subsection 410.120(e) requires "meters installed after January 1, 2001 shall, at a minimum, meet the standards set forth in Section 4.7 of the American National Standards Institute's (ANSI) Code for Electricity Metering." In its audit, Staff found that ComEd does not install meters in compliance with Subsection 410.120(e), and that ComEd has not received a modification or exemption regarding Section 410.120(e). Since a modification or exemption has not been granted to ComEd, Staff assured the Commission that it will continue its oversight of ComEd's metering practices and take the action necessary to ensure compliance with Commission rules.

VI. RESPONSE TO COMMISSIONER QUESTIONS RELATED TO DEMAND RESPONSE

Staff's Position

In a letter dated March 16, 2006, Commissioners Ford and Lieberman submitted a list of questions to the Administrative Law Judges ("ALJs"). ("Commissioners' Questions") regarding the topic of demand response and other topics. These questions seek comment on the findings and recommendations of research reports that analyze various demand response issues. The research reports include (1) a report submitted by the Department of Energy ("DOE Report,") to the U.S. Congress and (2) a report from the International Energy Agency ("IEA") entitled "DRR Valuation and Market Analysis" ("IEA Report").

Further, the Commissioners' Questions seek comment on a policy statement contained within the Energy Policy Act of 2005 ("EPAct"). Other questions concern Staff's proposed real-time pricing pilot program, especially how Staff's proposed program relates to the ongoing real-time pricing program operated by the Community Energy Cooperative. Real-time pricing issues are discussed in Section IV.F.27. Finally, Staff provided input regarding the benefits to the system if the incentives to large industrial customers are sufficient enough to cause the customer to shift their load from peak periods to non-peak periods.

A. DOE Report

Staff's Position

Staff witness Schlaf testified that the DOE Report, which was submitted to Congress in February 2006 in response to Section Sec. 1252(d) of EPAct, provides an overview of demand response programs in the United States, with a focus on the potential benefits of the introduction of demand response programs. He stated that the potential benefits of a given program, which may include "participant financial benefits," "market-wide financial benefits," "reliability benefits" and "market performance benefits," depend on numerous factors, including assumed participation rates, customer interest and responsiveness to available programs, and local market characteristics. (ICC Staff Exhibit 22.0 Corrected, p. 3)

Dr, Schlaf noted that the DOE Report also discusses the costs of demand response programs, which the report classifies as "participant" costs and "system" costs. The net benefits of demand response programs cannot be evaluated without an estimate of these costs. However, the DOE Report notes that there does not appear to be a consensus on a standard to evaluate the net benefits of the various types of demand response programs, and the report recommends that interested parties undertake a collaborative effort to establish standard evaluation methods. As a result, the DOE Report does not provide an estimate of the potential national benefit of the widespread implementation of demand response programs. (*Id*., pp. 3-4)

The DOE Report offers several findings and recommendations. Dr. Schlaf's commented on the feasibility of applying each finding/recommendation to the ComEd service area. (ICC Staff Exhibit 22.0 Corrected, pp. 6-11; Staff IB, pp. 146-147)

B. IEA Report

Staff's Position

Dr. Schlaf also testified about the IEA Report, which focused on the different types of methodologies that are used to estimate the value of incorporating demand response resources ("DRR") into a resource portfolio. In one type of methodology, an attempt is made to determine what the value of DRR was after it was added to a resource portfolio, while other seek to determine the benefits of adding various types of DRR in resource portfolios. Yet other studies evaluate the reliability effects of adding DRR to a resource portfolio. (ICC Staff Exhibit 22.0 Corrected, p. 15)

Dr. Schlaf noted that the IEA Report concludes that certain types of DRR would be cost-beneficial under most conditions, including the following: 1) "mass-market direct load control of appliances that can provide load relief in a matter of minutes;" 2) "under-frequency relays installed on specific equipment that will be tripped the second voltage drops to unacceptable levels;" and 3) "large customer interruptible programs where several hours' notice may be required. " (IEA Report, p. 4) Dr. Schlaf noted that ComEd has already adopted the first and third types of DRR from this list. (*Id*., pp.15-16)

Dr. Schlaf stated that the IEA report explains that a shorter-term analysis the impacts of adding to DRR to a portfolio can employ the type of cost-benefit models that are have been often used to evaluate the cost-effectiveness of demand-side management programs. The IEA Report notes that most DRR evaluation studies use a variation of this methodology. For example, the State of California studied critical peak pricing programs using this methodology, as did some Wisconsin utilities when conducting an evaluation of TOU rates. Dr. Schlaf noted that results of Staff's pilot program could be analyzed using this type of cost-benefit approach. (*Id*., pp.17-18)

C. EPAct Policy Statement

Staff's Position

Dr. Schlaf also testified with respect to the policy statement from EPAct [Section 1252 (f)] that is quoted in the Commissioners' letter. The Commissioners' Questions seek comment concerning (1) how CUB's proposed pilot program would further policy and (2) how Illinois should recognize and value the benefits described in this Section.

Dr. Schlaf noted that ComEd proposes to offer Rate BES-H, an hourly-based rate, to all customer classes, including the residential class. In order to take this rate, a residential customer would have to lease a meter that is capable of recording hourly usage (i.e., an IDR meter). While the cost of an IDR meter might be insignificant in comparison to the total cost of a large customer's bill, incremental leasing charges would constitute fraction of a small customer's electric bill. Dr. Schlaf stated that the CUB proposal would require all residential customers to pay for a residential customer's meter, and therefore the CUB proposal would facilitate the introduction of RTP to residential customers. (ICC Staff Exhibit 22.0 Corrected, p.13)

Dr. Schlaf noted the excerpt from EPAct appears to state that the benefits to non-participants of moving some customers to RTP should be recognized. Dr. Schlaf stated that while such a policy may generate non-participants benefits, a <u>net benefits</u> analysis should be conducted prior to implementation of a program that directly benefits participating customers only. (*Id*., pp.13-14)

D. Real-time Pricing / Energy Smart Pricing Program

<u>Staff's Position</u>

See the discussion at Section IV.F.27.

E. 24-Hour Maximum Kilowatts Delivered ("MKD")

<u>Staff's Position</u>

Commissioners Lieberman and Ford posed questions to the parties regarding ComEd's proposal that the billing demand for certain demand-based rates be based on the highest 30-minute demand during the monthly billing period (i.e., 24 hour demand period). Staff finds that there would be cost and reliability benefits to the system if incentives succeed in causing large industrial customers to shift their load from peak periods to non-peak periods. (ICC Staff Exhibit 23.0, pp. 2-4) In addition, Staff reviewed how other restructured states have priced distribution service for large customers and finds that other state commissions appear to make individual decisions concerning the appropriate customer characteristics to measure and then set rates accordingly. (ICC Staff Exhibit 23.0, p. 8) The implication is that the Commission should determine the objectives it wishes to achieve in the ratemaking process.

1. Impacts of Moving Load to Non-Peak Periods

<u>Staff's Position</u>

The first set of questions Mr. Lazare responded to were:

> From a system-wide perspective what are the benefits from incenting large industrial customers to switch their load to non-peak times (i.e., reducing load on distribution system, reducing peak energy consumption, etc.)? IIEC Witness Stephens talks about the beneficial impact of off-peak operation by customers on network distribution facilities.
>
> - Could the parties please comment in greater detail on these associated benefits?
>
> - Please present evidence to substantiate your comments. (p. 5)
>
> and
>
> - We know that there is value to improving the distribution load profile. ComEd is arguing that there is no benefit to incent that in their rates. Please comment as to whether there are benefits to the distribution company in terms of avoided cost related to flattening the load. Please discuss.

Staff witness Lazare explained that the system stands to substantially benefits from incentives that successfully cause large industrial customers to shift loads to non-peak hours. Staff demonstrated that these benefits are reflected in the assumptions of ComEd's own cost of service study submitted for this proceeding which shows that the large majority of the costs large industrial customers impose on the distribution system (over 99%) are driven by their peak period demands. (ICC Staff Exhibit 17.0, pp. 38-39) If these customers are able to shift demand from peak to non-peak hours, their overall contribution to system costs will decline accordingly. (ICC Staff Exhibit 23.0, p. 2)

Staff also contends that the reliability of the system may also improve. If incentives cause large industrial customers to shift their demands to non-peak periods there stands to occur significant benefits to system reliability. Peak period demands place maximum stress on a utility system, which can lead to interruptions or breakdowns in reliability. To the extent that demands are shifted to non-peak periods, the stresses on system reliability may be reduced. (ICC Staff Exhibit 23.0, p. 2)

Another benefit Staff has identified is that shifting the loads of large industrial customers to non-peak hours would help offset the tendency of power costs to spiral upwards during peak hours. Power costs are generally understood to be highest during the peak period. These power costs are increasingly determined in the electricity market by the intersection of supply and demand. The tendency of power costs to spiral upwards during peak hours is cause by less supply. To the extent that peak period demands are shifted to non-peak hours, overall demand for power will decline during the peak period, thus increasing the amount of supply and helping offset the spiraling effect of power costs during peak hours.

2. How Other Restructured States Have Priced Distribution Service for Large Customers

Staff's Position

Staff reviewed tariff pages for large customers in states that have restructured their electricity markets, Staff found that some charges are based on demands during peak hours only, while others are based on 24 hour maximum demands as ComEd proposes to employ in this proceeding. (*Id*.). This variability indicates that there is no single, generally-accepted way to determine peak demands for setting demand charges.

Staff witness Lazare notes that state commissions appear to make individual decisions concerning the appropriate customer characteristics to measure and then set rates accordingly. (ICC Staff Exhibit 23.0, p. 8) The implication for the Commission, Staff asserts, is that the Commission should determine the objectives it wishes to achieve in the ratemaking process and then set rates that further those objectives. In Staff's estimation, the most reasonable and beneficial approach would be to reject the Company's proposal to move to a 24 hour maximum demand for all customers.

Respectfully submitted,

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