**STATE OF ILLINOIS**
**ILLINOIS COMMERCE COMMISSION**

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

# <u>IIEC INITIAL BRIEF ON EXCEPTIONS</u>

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**INDEX**

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## IIEC INITIAL BRIEF ON EXCEPTIONS

COME NOW the Illinois Industrial Energy Consumers ("IIEC"), by their attorneys, Lueders, Robertson & Konzen LLC and Conrad Reddick, and pursuant to 83 Ill. Adm. Code Part 200.830, and Section 10-111 of the Public Utilities Act ("Act" or "PUA") (220 ILCS 5/10-111), offer the following Brief on Exceptions to the Administrative Law Judges' ("ALJs") Proposed Order ("PO" or "Proposed Order") dated June 8, 2006.

## I.

## INTRODUCTION

IIEC agrees with and supports substantial portions of the Proposed Order. However, it respectfully seeks clarification of, and takes certain exceptions to, the Proposed Order's:

(1) failure to adopt IIEC's position with regard to the appropriate level of General and Intangible ("G&I") plant to be reflected in rate base; (PO at 24-25)

(2) failure to adopt IIEC's recommendation with regard to the appropriate level of Administrative and General ("A&G") expense; (PO at 68 and Appendix)

(3) recommendation that a capital structure consisting of 54% debt and 46% common equity be adopted for ratemaking purposes for Commonwealth Edison Company ("ComEd"); (PO at130)

(4) failure to adopt IIEC's recommendation of 9.9% as the appropriate return on common equity for ComEd for ratemaking purposes; (PO at 155)

(5) adoption of the overall return on rate base of 8.20%; (PO at 155)

(6) failure to require ComEd to present a cost of service study incorporating the minimum distribution system in its next case; (PO at 164-165)

(7) failure to adopt IIEC's recommendation with regard to the establishment of rates for high voltage customers with demands in excess of 10 MW. (PO at 198).

IIEC's proposed replacement language for each of its numbered Exceptions is presented in Appendix A to this brief. In addition to substantive changes, in some instances IIEC has proposed changes to language in the PO's prefatory summaries of parties' positions and arguments in Sections of the Proposed Order relevant to IIEC's Exceptions. The suggested changes are consistent with the traditionally objective character of the Commission's summaries. For example, some prefatory paragraphs described a particular party's evidence as having "shown" or "established" a disputed fact. Such language exposes the Proposed Order to needless criticism and can compromise the clarity of its holdings, especially where the Commission's ultimate conclusion may be wholly inconsistent with the facts allegedly "established" by one party's evidence.

The captions for the Exceptions discussed in this Brief follow the captions of the Proposed Order and the numbering proposed by ComEd.

**Exception 1**

## IV. Rate Base

### B. General Plant: Functionalization and Amount; Intangible Plant; Functionalization and Amount

The Proposed Order concludes that neither IIEC nor the Staff presented evidence to show that the level of G&I plant costs ComEd seeks to reflect in rates is not used and useful or was unreasonably incurred. (PO at 24). It reasons that IIEC and Staff rely on the Commission's decisions in the last ComEd rate case to disallow a portion of ComEd's G&I plant. (Id.). It further suggests this is not a proper basis for determination of costs in this rate case. (Id.). The Proposed Order agrees with ComEd that use of "direct assignment" is preferred over the labor allocator ". . . because determining such costs is possible . . . ." (PO at 25.). The Proposed Order concludes that the evidence in the record supports the conclusion that use of a labor allocator would tend to increase G&I plant. (Id.).

The Proposed Order also rejects IIEC's arguments to limit the increase in G&I plant costs to the percentage increase in distribution plant costs because it is allegedly not supported in the record and IIEC purportedly failed to provide a cogent reason for the correlation between G&I plant and distribution plant. (Id.).

IIEC did not address the issue of the appropriate functionalization of G&I plant. Therefore, the Proposed Order's discussion of and decision on whether the appropriate means of allocating G&I plant through a labor allocator or direct assignment method does not affect IIEC's position with regard to the appropriate level of G&I plant to be reflected in rates.

IIEC addressed the appropriate level of G&I plant to be reflected in the Company's rates in its Initial Brief at pages 8-9 and in its Reply Brief at pages 3-7. IIEC's position is based on Commission findings in recent delivery service cases. There the Commission found a relationship between the increase in the level of distribution plant and the level of G&I plant. (*See* Illinois Power Company, ICC Dkt. 01-0432, Order, March 28, 2002 at 17 where the Commission determined the level of G&I plant to be reflected in Illinois Power's rates based on the ratio of G&I plant to distribution plant.)[1]

The record in this case establishes a similar relationship between distribution plant and G&I plant. G&I plant is used in support of distribution plant. (*See* Chalfant, IIEC Ex. 2.0 at 7:125-130; Heintz, ComEd Ex. 11.0 at 14:300-306). Consistent with that relationship, ComEd argues that its G&I plant cost in this case is distribution related. (*See* Heintz, ComEd Ex. 11.0 at 16:330-341 explaining the use of the direct assignment for G&I plant in this case to the distribution function; *see also*, Costello, ComEd Ex. 30.0 at 12:255-256 stating G&I plant cannot be attributed to production).[2] If there were no relationship between G&I plant and distribution plant, it is difficult to see how any G&I plant could be assigned to the distribution function. In other delivery service cases, the Commission has accepted that there is a relationship between the level of G&I plant and the level of distribution plant. In the Illinois Power case, supra, the Commission found, in the

[1]The Commission's decision to set the level of G&I plant as a percentage of distribution plant and distribution labor expense was affirmed on appeal. (Illinois Power Co. v. Illinois Commerce Commission et al., App. Ct. Dkt. 5-02-0466 (ICC Dkt. No. 01-0432) 5th Dist. App. Ct. May 22, 2003).

[2]*See also* Heintz, ComEd Ex. 11.1, Sch. 1 at 1 and 4, showing allocation of G&I plant costs among transmission and distribution functions.

absence of evidence explaining the very large increase in G&I plant, it would use such a relationship to determine the reasonable level of G&I plant costs. Thus, it is reasonable for the Commission to conclude there is a correlation between the level of G&I plant and the level of distribution plant.

The record in this case shows that the level of distribution plant investment for ComEd increased by 24.5%. (Chalfant, IIEC Ex. 2.0 at 7:131-132). However, ComEd seeks to increase its G&I plant costs by 222.2%. (Id.).

IIEC's recommendation on the appropriate level of G&I plant is consistent with past Commission delivery service orders, (one of these orders having been affirmed on appeal) and is supported by the evidence. IIEC's recommendation to limit the increase in G&I plant costs to the percent increase in distribution plant should be adopted by the Commission. IIEC sets out its proposed language for the modification of the Proposed Order on this issue in Appendix A to this Brief.

**<u>Exception 2</u>**

**V. Operating Expenses and Revenues**

**C. Administrative and General Expenses;**

**2. Overall Amount**

The Proposed Order merely states that its conclusion on the appropriate overall amount of A&G expense ("overhead") to be reflected in ComEd's rates is shown in its Appendix A. (PO at 68). Appendix A of the PO shows the numeric value of the overhead to be included in rates and the numeric value of certain adjustments made thereto. It does not specifically explain how or why those values were determined.[3]

IIEC addressed the amount of overhead that should be included in ComEd's rates in its Initial Brief at pages 10-11 and in its Reply Brief at pages 7-12.

The Proposed Order correctly recognizes it was IIEC's position that to the extent the Commission approved an increase or decrease in the level of operating and maintenance expense, other than A&G, the level of A&G (overhead expense) should be increased or decreased proportionately. (PO at 60). ComEd's original proposal for increased overhead expense constituted over one-fourth of its total requested revenue increase of $350.7 million. (Chalfant, IIEC Ex. 2.0 at 5:84-85). Under ComEd's current cost levels, approved by the Commission in ComEd's last case, A&G added approximately 35.8 cents to every dollar of O&M expense, other than A&G expense, needed to provide delivery service. (Id. 5:86-88). At the expense levels filed by ComEd in its original case, the increase in overhead would have added 63.2 cents to every dollar of non-A&G O&M required for delivery service. (Id. at 5:88-91). It was IIEC's position that ComEd should be required to explain why there should be such a significant increase in the overhead expense in this case, from the levels deemed reasonable by the Commission in ComEd's last delivery case. ComEd did not provide such an explanation. IIEC recommended that, because ComEd has not explained the precipitous jump in its expenses, the increase allowed should be

[3]IIEC's Brief outline combined issues of the Functionalization and the Overall Amount of A&G. It should have treated these issues in separate captions. IIEC only addressed the overall amount of A&G and respectfully recommends its argument on the overall amount, which is now in the Functionalization Section, be moved to the Section dealing with the overall amount of A&G.

consistent with the relationship of A&G (overhead) to O&M, other than A&G, the Commission deemed reasonable in ComEd's last case. (Id. at 5:94-109). A&G should be increased or decreased in proportion to the increase in O&M, other than A&G, authorized by the Commission in this case. (Id. at 99-102).

Again, IIEC's approach to determining the appropriate level of A&G expense is consistent with the methodology adopted by the Commission in other delivery service cases. In Illinois Power Company Docket No. 01-0432, the Commission accepted Staff and IIEC arguments that the relationship between A&G expense and distribution operating expense should be maintained in the absence of an explanation of the significant increase in A&G expense. (<u>Illinois Power Company,</u> ICC Dkt. No. 01-0432, Order, March 28, 2002 ("Illinois Power") at 48). The record here shows that ComEd proposed an increase in A&G that was $97.3 million or 55% higher than the level found just and reasonable in ComEd's last case. (Chalfant, IIEC Ex. 2.0 at 4:72-74). IIEC witness Chalfant suggested the appropriate standard for ratemaking purposes in this case was to maintain the relationship, between the A&G and O&M, other than A&G, the Commission found just and reasonable. (*See* Chalfant, Tr. 1690).

The Commission's decision in <u>Illinois Power</u> supports Mr. Chalfant's position. There, the Commission found there had been no showing that electric distribution operations required such a large increase in A&G relative to the levels approved in prior cases. (<u>Illinois Power Company</u>, ICC Dkt. No. 01-0432, Order, March 28, 2002 at 48). The Commission stated:

> The Commission notes that while IP claims to have significantly reduced its electric A&G expenses between 1997 and 2000, it does not reconcile these claims with the fact that it has requested to

> recover from distribution customers a significant increase in the level of A&G expenses. . . . the Commission cannot find that IP has adequately explained the significant increase in electric distribution A&G expenses relative to the level approved in 1999. (Id.).

Because ComEd has not adequately explained the substantial increase in A&G expense over the levels determined to be just and reasonable in the last case, Mr. Chalfant recommended, as the Proposed Order correctly notes, that A&G expenses be increased or decreased in proportion to the increase or decrease in O&M expense determined to be adequate for the provision of delivery service. This would maintain the relationship between ComEd's overhead expense and O&M, other than A&G, as adopted in the last case. (Chalfant, IIEC Ex. 2.0 at 5-6:99-109). Beyond the absence of an explanation for the significant increase in A&G in this case, Mr. Chalfant testified that ComEd's A&G expenses were unreasonable. ComEd's overall O&M expense, including A&G, had increased only about 5.6%, however, ComEd proposes to increase it's A&G expense by 55%. (Chalfant, IIEC Ex. 2.0 at 4:72-73; Chalfant, Tr. 1693-1695; ComEd Cross Ex. 13). ComEd did not explain this relatively large increase in its overhead. (Id. at 4-5:71-93).

In sum, IIEC's position is consistent with past Commission delivery service rate orders, its recommendation is supported by evidence in the record, and ComEd has not explained the substantial difference in A&G expense over the levels approved in the last case. Therefore, IIEC's position that A&G expense should be increased or decreased in proportion to the increase or decrease in O&M, other than A&G, approved in this case in order to maintain the relationship, between A&G and O&M, other than A&G, the Commission found reasonable in ComEd's last case should be adopted by the Commission.

IIEC's recommended language for modification of the Proposed Order to adopt IIEC's position is contained in Appendix A to this Brief.

**Exception 3**

## VI. Rate of Return

### A. Capital Structure

The Proposed Order correctly concluded that the equity supporting ComEd's net $2.346 billion of goodwill should be excluded from ComEd's ratemaking capital structure. (PO at 128). IIEC submits that in doing so, the Proposed Order fails to give appropriate weight to IIEC's examination of the equity actually supporting ComEd's regulated services, which is an additional, independent basis for that conclusion and should be expressly endorsed in the order.

However, after reaching the correct conclusion on the proper content of ComEd's capital structure, the Proposed Order ignores the dictates of its own fact and legal analyses when it subjectively defines a 54%-46% (debt-equity) capital structure for ComEd that includes a portion of the equity its analyses exclude. (PO at 127-129). (*See also*, the Proposed Order's satement that the Commission determines in the Capital Structure Section, a portion of goodwill should be included in the capital structure. (PO at 155)). The Proposed Order's adoption of that arbitrary structure instead of the Staff recommendation to exclude all of the goodwill equity is neither supported by the record nor consistent with the legal mandates described in the order.

Based on the evidence and analysis in Staff's and IIEC's testimony and IIEC's briefs, and for the additional reasons stated in the following paragraphs, the Proposed Order should be modified to adopt Staff's recommended 62.89%-37.11% (debt-equity) capital structure, which is opposed only by ComEd.

Language to conform the Proposed Order's finding to the record evidence and the law is included in Appendix A to this brief.

### *1. The Evidence of Record and the Findings of the Proposed Order Compel Adoption of Staff's Recommended Capital Structure*

According to the Act, the Commission must decide what equity costs ComEd has shown are reasonable and prudent investment costs that are used and useful in providing its delivery services. (220 ILCS 5/9-201; 220 ILCS 5/9-211). ComEd failed to provide the required proof as to the equity supporting its goodwill. The Proposed Order concludes that "ComEd's equity figure contains the net $2.634 billion in goodwill generated from the transfer of its plants." Further, because "[i]ncluding this figure in equity necessarily will raise the required rate of return, and therefore the rates set herein," the Proposed Order finds that ". . . ComEd may not make such a recovery through regulated rates."

IIEC agrees. ComEd's goodwill is not used and useful for the utility's provision of its regulated delivery services and the supporting equity should be excluded from ComEd's ratemaking capital structure. However, the testimony of IIEC witness Michael Gorman provides an independent and even stronger basis for the Proposed Order's exclusion of goodwill equity. (*See* Gorman, IIEC Ex. 7.0 at 3-16; Gorman, Tr. 1960-2060). The Proposed Order should be amended to incorporate this additional support. That testimony and other record evidence on this issue was examined in IIEC's Initial Brief at pages 12-19 and in its Reply Brief at pages 14-30.

Mr. Gorman's analysis is unaffected by the accounting mechanics of ComEd's nuclear plants transfer. It is a straight-forward determination of whether the equity supporting ComEd's goodwill is used and useful in providing its delivery services.

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

(Gorman, Tr. 2054 (*emphasis added*)).

In summary form, here is the essential evidence the record presents.

- ComEd's goodwill asset is not a transmission or distribution asset. (Gorman IIEC Ex. 7.0 at 8:173)

- ComEd's goodwill is not used in providing the utility's regulated delivery services. (Houtsma, Tr. 409-410). In fact, ComEd has excluded the goodwill from its delivery services rate base in this case. (Houtsma, Tr. 426:16).

- ComEd's goodwill is supported only by ComEd equity, since "goodwill does not produce revenues and cash flows, and therefore could not be supported by debt capital." (Gorman IIEC Ex. 7.0 at 8:185 *citing* ComEd response to IIEC DR 4.01(d); Gorman, Tr. 1986).

- Financial analyses showed that excluding this goodwill equity results in a total capitalization that reasonably reflects ComEd's total rate base and a capital structure that reflects the sources of capital supporting delivery services. (Gorman, Tr. 2054). That is, Staff's recommended capital structure allows ComEd to recover all its delivery service debt requirements and the costs of equity actually used and useful in providing delivery services.

Mr. Gorman provided a common sense explication of his analysis in his oral testimony.

> I had the same objective as Staff witness Ms. Kight's (*sic)* had, and that was to identify the amount of Commonwealth Edison's capital

> that supports it's (*sic)* regulated transmission and distribution utility rate base. And I did that by first looking at the total capital upon ComEd's balance sheet and that was over $11 billion. I looked at the test year rate base, that was $6 billion. Clearly, you don't need $11 billion of capital to finance a $6 billion rate base. So my next question was, Well, what's the difference? What's the major difference between rate base and capital? The major difference was a good will asset of about $4.9 billion. The evidence in the record clearly shows that that $4.9 billion good will asset is financed entirely by common equity. So that good will is not a transmission distribution asset, it's financed with common equity, it's appropriate to carve that common equity out of capital structure and attribute it only to the good will asset.

(Gorman, Tr. 2051-2053). The Proposed Order should be amended to incorporate this distinct analysis, which provides an additional basis for excluding ComEd's goodwill equity from its ratemaking capital structure, further bolstering the Proposed Order's correct conclusion on that point. .

Ultimately, the Proposed Order correctly "rejects ComEd's proposed equity figure of 54.2%, which includes a recovery from ratepayers based on billions the of dollars of goodwill that was avoidable under Section 16-111(g)(4)." (PO at 129). The Proposed Order expresses "the Commission's concurrence with Staff that the 'actual' capital structure proposed by ComEd in this case is distorted relative to original cost rate base." (PO at 129). The Proposed Order also concludes that Staff's methodology for determining a reasonable capital structure for ComEd should be adopted.

But, the Proposed Order applies that methodology only "to the extent that the net adjustments produce a capital structure consisting of 46% equity and 54% debt." (PO at 130). Although this subjectively determined ratio purports to balance the effects of ComEd's "balloon of goodwill" and “sharp swings” in the Company’s capital structure” (Id.), the Proposed Order’s common equity ratio of 46% is at odds with the factual findings in this case on ComEd's costs of providing delivery services. The Proposed Order includes a portion of the goodwill (PO at 155) it has just concluded should be excluded, (PO at 128), based only on a concern whether the level of ComEd’s debt is properly reflected. (PO at 130).

This concern that ComEd might not recover its costs prompted the Proposed Order to compare ComEd’s debt-to-total capital ratio and the capital structures of other utilities. For reasons the Proposed Order voices in another context, such comparisons to different utilities with disparate circumstances are legally irrelevant and an unlawful basis for a Commission decision. (*See* PO at 153 and Exception 4, *infra*).

In any case, the Proposed Order’s concern about confiscatory rates (PO at 130) is unfounded. As Mr. Gorman pointed out, Staff’s recommended capital structure allows ComEd to recover all its delivery service debt requirements and the costs of equity actually used and useful in providing delivery services. (Gorman, Tr. 2054). Moreover, as the Proposed Order notes, Staff expert Sheena Kight evaluated the financial effects of her recommended capital structure using ComEd's business profile score and the published financial ratio guidelines for S&P's credit ratings to assure that the proposal provided the financial strength necessary to access the capital markets under most conditions, and at a reasonable cost. (PO at 119-120). Ms. Kight concluded that Staff's proposed adjusted capital structure is commensurate with at least a BBB credit rating, which provides an adequate degree of financial strength to meet financial commitments and access to debt capital under most, if not all, financial market conditions.

In fact, as the Proposed Order noted, Ms. Kight's analytical method directly addressed the apparent concern whether ". . . Staff's capital structure properly reflects ComEd's level of debt." (PO at 130).

> 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 ratio neither reflects the cost of a company's debt nor the cash flows available to meet its debt service obligations.

(PO at 120).

Finally, both Ms. Kight and Mr. Gorman found Staff's proposal and the capital structures of firms in the proxy groups of IIEC and Staff actually are comparable when one removes ComEd's transitional funding notes ("TFNs") from its debt component -- a step ComEd has acknowledged is appropriate in assessing its financial risk. (*See* IIEC Reply Br. at 36-37). Both analyses, which are in the record, found that ComEd's financial requirements would be met, while maintaining its access to capital and current credit rating.

Even if such comparisons were appropriate, more compelling comparisons to ComEd's own past capital structures support adoption of Staff's recommendation. The Proposed Order's 46%common equity ratio is a significant increase over (and unreasonable in comparison to) the common equity ratios found reasonable for ComEd both before and after creation of the goodwill asset. In Docket 99-0117, the Commission found a 39.4% equity ratio reasonable based on a test year that pre-dated ComEd's creation of its goodwill asset in 2000. (Commonwealth Edison Company, ICC Dkt. 99-0117, Order, August 26, 1999, at 46). The Proposed Order's 46% common equity ratio is also significantly greater than the 42.86% common equity ratio found reasonable in Docket 01-0423, immediately after creation of ComEd's goodwill asset. (Commonwealth Edison Company, ICC Dkt. 01-0423, Order, April 1, 2002, at 116).

The Proposed Order finds:

- "[T]he Commission does not view a difference in the proportion of debt to signal a problem *per se*. . . ." (PO at 127).

- "Weighing all of the considerations discussed above, the Commission finds that Staff's methodology should be adopted . . . ." (PO at 130).

- "[T]he Commission believes that Staff's adjustments have merit . . . ." (PO at 130).

The Proposed Order's arbitrary rejection of the results of Staff's methodology is contrary to the extensive evidence of record and the legal positions the PO that support adoption of Staff's methodology and the conclusion that ComEd's proposed capital structure is unreasonable and unlawful.

Moreover, as explained below, this rejection of Staff's recommended capital structure is legally untenable.

*2. The Governing Legal Mandates, As Interpreted by the Proposed Order, Compels Adoption of Staff's Recommended Capital Structure*

The Proposed Order errs again when it ignores the dictates of its own arguments, which compel modification of its conclusion and adoption of Staff's recommended capital structure, a recommendation supported by all parties other than ComEd. The Proposed Order's recitation of the law requiring the Commission to exclude, for ratemaking purposes, costs attributable to the equity supporting ComEd's goodwill cannot seriously be questioned.

The crucial elements of the Proposed Order's legal reasoning are as follows.

> [T]he Commission should disallow recovery of any cost of capital in excess of that reasonably necessary for the provision of services. If a utility has included excessive equity in its capital structure, it has inflated the rate of return and its capital cost.

(PO at 127, *quoting CUB v. ICC*, 276 Ill. App. 3d 730 (1995) at 746).

> ComEd's equity figure contains the net $2.634 billion in goodwill generated from the transfer of its plants.

(PO at 128).

> We hold that if a utility[] . . . pays one dollar more for capital because of its affiliation with an unregulated or nonutility company, the Commission must take steps to ensure that such increases do not enter in its ROR [rate of return] calculation.

(PO at 128, *quoting Ill. Bell Tel. Co. v. ICC*, 283 Ill. App. 3d 188 (1996) at 207). In consideration of these legal requirements and the evidence of record, the Commission found that "ComEd may not make such a recovery through regulated rates." (PO at 128).

Inexplicably, the Proposed Order declines to apply the statutory and case law it describes so well or to act consistently with its own conclusions of law. After clearly articulating the requirements that compel adoption of Staff's capital structure, the Proposed Order adopts a capital structure that no party recommended and that is wholly unsupported by any quantitative record evidence. It does so solely on the basis of a comparison analysis the Proposed Order rejects in a related context. Such unsupported, subjective determinations are arbitrary and capricious and cannot be sustained. *(See* 220 ILCS 5/10-201(e)(iii) ("decision does not contain findings or analysis sufficient to allow an informed judicial review") and 5/10-201(e)(iv)(A) ("findings of the

Commission are not supported by substantial evidence bases on the entire record")).

In fact, the PUA requires the opposite -- that ComEd, the utility to which the burden of proof is expressly and unequivocally assigned, prove by a preponderance of the evidence that the amounts it seeks to recover through tariff rate increases are actual, prudent, just and reasonable costs of providing its regulated delivery services. (5 ILCS 100/10-15; 220 ILCS 5/9-201(c)). ComEd has not met that burden of proof. As to its goodwill, ComEd has conceded that "Goodwill could not be ascribed to any particular assets," including the distribution assets ComEd uses to provide its regulated delivery services. (Houtsma Tr. 410, *also* 412). Therefore, ComEd has failed to meet its burden of proof.

Though the bases for the ultimate failure to exclude all goodwill are not clear, the Proposed Order also refers to its observations respecting other utilities. "The Commission notes that Staff's proposal is not comparable to previously approved capital structures for ComEd or other financially sound utilities. . . ." (PO at 130). But, the Proposed Order unequivocally rejects a similar argument with respect to ComEd's cost of equity.[4] If one simply substitutes "capital structure" for "cost of equity" in the PO's treatment of that argument, (*see* PO at 153) it is equally powerful and fully applicable here.

> The [capital structure] appropriate to ComEd, however, is specific to that utility. ComEd may not simply adopt the [capital structure] set for other utilities scattered around the country, for which the facts and circumstances are not necessarily similar. Rather, pursuant to Section 9-201 of the Act, ComEd must prove that its proposed [capital structure] is just and reasonable.

[4]The Proposed Order rejected ComEd's assertion that its cost of equity should reflect the determinations made for other U.S. utilities. (PO at 153).

In fact, the Proposed Order recognizes the uniqueness of ComEd's circumstances. "ComEd witness Hadaway criticizes the Staff proposal because it contains much more debt than the respective capital structures of the companies in the sample group utilized to estimate the cost of common equity. In light of the plant transfers, the Commission does not view a difference in the proportion of debt to signal a problem *per* se."[5] (PO at 127).

ComEd has offered no evidence showing that its goodwill asset actually supports its provision of delivery services. (*See* IIEC Init. Br. at 15; Reply Br. at 17). Indeed, the Proposed Order expressly finds that the goodwill at issue is a result of ComEd's discretionary structuring of a generation plant transaction with an unregulated affiliate, establishing multiple facts that compel its exclusion. (PO at 128-129; *see also Ill. Bell Tel. Co. v. ICC*, 283 Ill. App. 3d 188 (1996) at 206-207 and 220 ILCS 5/9-201 and 5/16-111(i)). Including ComEd's goodwill as part of the equity component of the utility's ratemaking capital structure would inflate its rate of return and its capital cost. (*CUB v. ICC*, 276 Ill. App. 3d 730 (1995) at 745-46).

The stated bases for the Proposed Order's deviation from the governing law -- a non-existent presumption and the cost structures of other utilities -- are legally impermissible. Moreover, there is absolutely no support in the record for the particular debt ratio chosen in the Proposed Order. Inclusion of a subjectively determined fraction of ComEd's goodwill in the utility's ratemaking capital structure -- without explanation -- is arbitrary and capricious and lacks the required record support, in violation of the Act.

[5]ComEd's unique combination of generation plant goodwill and transitional funding notes precludes true"apples to apples" comparisons.

> The action of an administrative agency is arbitrary and capricious if the agency (1) relies on factors which the legislature did not intend for the agency to consider; (2) entirely fails to consider an important aspect of the problem; or (3) offers an explanation for its decision which runs counter to the evidence before the agency, or which is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."

(*CIPS v. ICC*, 122 Ill.2d 462 at 480 and 220 ILCS 5/10-201(e)(iii) and 5/10-201(e)(iv)(A)).

The Proposed Order must be modified, as shown in Appendix A of this Brief, to remove, in its entirety, the equity supporting ComEd's goodwill from the utility's ratemaking capital structure.

**Exception 4**

**VI. Rate of Return**

**C. Cost of Common Equity**

In its Reply Brief, IIEC pointed out that ComEd's attempt to use its comparisons to other utilities as an evidentiary foundation for a decision in this case was impermissible. (IIEC Reply Br. at 25-26). The cost of capital decisions of other commissions, in other states, for different utilities, with no showing that there was any similarity of relevant circumstances, is an unlawful basis for any determination in this case. Any such decision must be based on the record of this case. (220 ILCS 5/10-201(e)(iv)(A)).

The Proposed Order agrees.

> The cost of equity appropriate to ComEd, however, is specific to that utility. ComEd may not simply adopt the cost of equity set for other utilities scattered around the country, for which the facts and circumstances are not necessarily similar. Rather, pursuant to Section 9-201 of the Act, ComEd must prove that its proposed cost of equity is just and reasonable.

(PO at 153).

The Proposed Order also correctly finds, as IIEC showed in testimony and explained in its briefs, that ComEd's DCF growth rate estimate overstates ComEd's true cost of capital. (PO at 154; IIEC Init. Br. at 21-24; IIEC Reply Br. at 30-32). ComEd's proposed 11.00% equity return was properly rejected. (PO at 154).

The investment bank based cost of equity recommendation of CUB/CCSAO/City also was rejected. The Commission could not find that ComEd and its parent firm, Exelon, necessarily "share identical risk factors." (PO at 154). The Commission determination on this point, however, "is restricted to the facts of the instant case and shall not in any way prevent parties in future cases from offering similar types of evidence." (Id. ). Thus, the Proposed Order recognizes the potential worth of direct observations of the equity return requirements of sophisticated equity sources like investment banks.

At the end of its analysis, the Proposed Order was left with only the cost of equity recommendations of Staff and IIEC as viable recommendations. The Proposed Order adopts Staff's higher cost of equity recommendation. But, that selection was based on a determination (a capital structure containing an arbitrary portion of ComEd's goodwill) that IIEC has shown to be both unjustified by the record and unlawful. (*See* Exception 3, Capital Structure, *supra*).

> The Commission finds, however, that IIEC's 9.90% proposal may be slightly too low <u>in</u> <u>light</u> <u>of</u> <u>their</u> <u>complete</u> <u>exclusion</u> <u>of</u> <u>goodwill</u> related to the plant transfers (*see, e.g.*, IIEC Init. Br. at 17-18) and our determination, *supra*, that a portion should be included in the capital structure. Accordingly, Staff's 10.19% cost of equity is adopted.

(PO at 155 (*emphasis added*)).

As IIEC demonstrated in support of its Exception 3, the "complete exclusion of goodwill" is not only supported by the evidence of record, but required by law. Revising the Proposed Order to comply with the governing legal requirements eliminates the PO's stated basis for selecting Staff's recommendation over IIEC's recommendation. The Proposed Order may not rely on its previous unlawful inclusion in ComEd's ratemaking capital structure of an arbitrary portion of a goodwill accounting asset that is unrelated to ComEd's provision of regulated delivery services. In these circumstances, the observed equity return requirements of ComEd's investment banks argue for adoption of a return level at the <u>lower</u> end of the range found reasonable by the Proposed Order. The Proposed Order should be amended to adopt IIEC's slightly lower 9.90% cost of equity recommendation.

**<u>Exception 5</u>**

## VI. Rate of Return

### D. Approved Rate of Return on Rate Base

Adoption of IIEC's recommended modifications of the Proposed Order will require modification of the calculation of ComEd's overall cost of capital to reflect the revised capital structure and cost of equity. The Proposed Order shows its derivation of the overall cost of capital in a single chart, referring to other portions of the order for explanations of the factors used. The chart in the section headed "Approved Rate of Return on Rate Base" should be modified as shown in Appendix A of this Brief, for the reasons discussed in connection with Exceptions 3 and 4 in this Brief.

**Exception 6**

**VII. Cost of Service Issues**

**B. Minimum Distribution System**

The Proposed Order correctly concludes that the Commission should be willing to consider the merits of the Minimum Distribution System ("MDS") approach in future rate proceedings, but it declines to adopt IIEC's suggestion that ComEd be required to present a cost of service study that incorporates this approach in its next case. (PO at 165). The Proposed Order also states that it rejects the MDS or zero intercept approach recommended by IIEC and BOMA for the allocation of distribution costs between the customer and demand functions. (PO at 164).

IIEC respectfully points out that it did not specifically recommend the use of the MDS or zero intercept approach for allocation of distribution costs in this case. IIEC witness Chalfant testified that he had not made any adjustments to the Company's cost of service study to reflect a MDS at this time. (Chalfant, IIEC Ex. 2.0 at 15:302-304). Therefore, the Proposed Order should be modified to reflect IIEC's position.

IIEC witness Chalfant also recommended that at a minimum, the Commission directed ComEd to make available to the parties the results of either a zero intercept analysis or a minimum system study of its distribution accounts 364 through 368 (IIEC Ex. 2.0 at 15:306-307). IIEC points out that in order for any party to perform a cost of service study that recognizes the minimum distribution system approach, so that the Commission may consider its merits in a future case, ComEd must provide the necessary information. This type of information is almost exclusively within the control of the Company. Therefore, IIEC requests that the Proposed Order be modified to indicate that the Company must make available to parties in the next rate case the results of a zero intercept analysis or a MDS study of distribution accounts 364 through 368.

IIEC sets out its language for the modification of the Proposed Order on this issue in Appendix A to this Brief.

**Exception 7**

## IX.. Rate Design

### A. Customer Class Delineations

#### Non-Residential

#### High Voltage Class Rates

The Proposed Order rejects IIEC's methodology for increasing/decreasing rates applicable to customers in the High Voltage Class.[6] (PO at 198). The Proposed Order concludes that IIEC recommended the rates for the entire high voltage class be increased or decreased in proportion to the increase or decrease in the ComEd revenue requirement in this case. (Id.). Specifically, IIEC recommended that rates applicable to over 10 MW customers, both at standard voltage and at high voltage (69 kV and higher), should be based on current rates (taking effect June 2006) and increased or decreased in proportion to the overall revenue increase or decrease that results from the Commission's determination in this case.[7] (Stephens, IIEC Ex. 1.0 at 16:301-308), IIEC did not recommend that rates for all customers in the proposed high voltage class be set in that manner.

[6]The High Voltage Class consists of high voltage (customers served at 69kV and higher) from the other current non-residential classes (Chalfant, IIEC Ex. 2.0 at 10:193-196).

[7]To the extent this was not previously made clear by IIEC and other parties, IIEC wishes to make it clear now.

IIEC noted that under its approach, these over 10 MW customers (standard and high voltage) would pay their respective share of the increase (or decrease) and would not cause any interclass shifts in cost responsibility such as might otherwise occur under the rate design changes recommended by ComEd. (Stephens, IIEC Ex. 1.0 at 16:308-311). IIEC presented evidence demonstrating that under ComEd's proposed rates, high voltage and standard voltage customers with demands in excess of 10 MW, respectively, will receive increases ranging from 109% to 133%. (Stephens, IIEC Ex. 1.0 at 7-8:Tables 1 and 2). Evidence was presented by the Department of Energy ("DOE") in this case that some high voltage customers with demands in excess of 10 MW could receive increases of 160%. (Swan, DOE Ex. 1.0 at 4:65-73). IIEC also showed that ComEd's current average delivery charge for a 20 MW hypothetical customer was 42% higher than the next highest major Illinois utility and would be 188% higher (i.e., almost three times higher) under ComEd's proposed rates. (Stephens, IIEC Ex. 1.0, Fig. 2 at 10).

The Proposed Order correctly recognizes these adverse impacts by accepting proposals made by IIEC and other parties to retain a separate rate class for 10 MW and over customers. (*See* PO at 195). However, the Proposed Order concludes that high voltage customers would not receive undue increases due to other conclusions reached in the Proposed Order, and the resulting rates would bear a reasonable relationship to the cost of providing service. (PO at 198). As explained below, this is not true for high voltage customers with demands greater than 10 MW.

IIEC believes there may be some confusion about (a) the favorable impact of creating a separate customer class for over 10 MW customers served exclusively at standard voltage and (b) setting rates for those customers at a level equal to the percentage increase or decrease in ComEd's revenue requirement. (PO at 194-196). Adopting the IIEC proposal for over 10 MW customers at standard voltage does not mitigate the increase for over 10 MW customers served at high voltage. This would only be the case if the Proposed Order adopts IIEC's original recommendation, which was to set rates for over 10 MW customers served at <u>standard and high voltage</u>, equal to the percentage increase or decrease in ComEd's revenue requirement. (*See* Stephens, IIEC Ex. 1.0 at 16:301-311).

Moreover, if IIEC's broader recommendation is not adopted, over 10 MW customers served at high voltage would be treated differently than they are now under ComEd's current rate structure. Under the current structure, these customers pay the standard demand charge applicable to all customers over 10 MW (standard and high voltage) under ComEd's Rate RCDS. (*See* ComEd Ex. 10.2 1st Rev. Sheet No. 241 - Rider HVDS and ComEd Rate RCDS original sheet 119.1). A high voltage credit is then applied to that demand charge under Rider HVDS for those over 10 MW customers served at high voltage. Thus, under the current rates, the effective discount for high voltage customers over 10 MW is $1.30 per kW under Rider HVDS. (*See* ComEd Ex. 10.2, 1st Rev. Sheet No. 241 and compare Stephens, IIEC Ex. 1.0, Tables 1 and 2). Customers served at high voltage receive a credit to recognize that they use less of the distribution system than those 10 MW customers served at lower voltages. (*See* Crumrine, ComEd Ex. 29 at 617-619).

Assuming the PO overall increse of 11.27% (PO at 303), IIEC's proposed rates for 10 MW and over customers at standard and high voltage would be $2.60 per kW ($2.34 x 1.1127), and $1.16 per kW ($1.04 x 1.127), respectively, yielding a difference of $1.44 per kW, which is comparable to the current $1.30 discount. However, under the PO approach, the discount is reduced. The final discount is not yet knowable[8], but at ComEd's proposed charge for the HVDS class at $2.17 ker kW, the discount would be only $0.43 per kW. ($2.60 - $2.17). Hence the PO conclusion results in a much smaller discount for customers over 10 MW taking service at high voltage than does the current structure or IIEC's proposed rate.

Adoption of IIEC's recommendation to increase or decrease rates for over 10 MW customers served at standard or high voltage would ensure that over 10 MW customers served at high voltage would effecitvely still be treated the same as under the current rate structure, as suggested by ComEd. (*See* Crumrine, ComEd Ex. 23 at 29:621-624).

Adoption of IIEC's proposal would also be consistent with the Proposed Order's correct decision to mitigate the increases (109% to 133% and in some cases 160%) to very large customers. (*See* PO at 192 and 195).

Further, the Proposed Order correctly finds there is a need to mitigate DOE's concern about the "enormous" increases for customers over 10 MW served at high voltage. (PO at 197-198). The Proposed Order suggests that its conclusions in the "Very Large Load Class" section of the Proposed Order may have mitigated DOE's concerns. (PO at 198). DOE does suggest that if the Commission adopts proposals for a system average increase for all customers with loads in excess of 10,000 kW, its concerns would be moot. (Swan, DOE Ex. 1.0 at 11:279-282). But the Proposed Order does not quite accomplish this. The proposal to limit the increase was made by IIEC witness Stephens, who recommended, as noted above, that the system average increase approach to setting

[8]Since final HVDS rates will depend on how changes in ComEd's revenue request are ultimately reflected in rates.

rates for over 10 MW customers be applied to all customers over 10 MW (standard and high voltage). (Stephens, IIEC Ex.1.0 at 16:301-311). If there was a belief, in drafting the Proposed Order, that IIEC's method for increasing or decreasing rates for over 10 MW customers would mitigate the "enormous" increases for over 10 MW customers served at high voltage, that belief will only be correct if IIEC's specific recommendation to increase or decrease the over 10 MW rates for both standard voltage and high voltage customers is adopted. If it is not adopted, these high voltage customers will still face the very large increases that were originally of concern to DOE and IIEC.

Finally, if IIEC's position is adopted, the average delivery charges for large customers in the ComEd territory will be more in line with, although still significantly higher than those of the other major Illinois utilities. As mentioned above, under the IIEC approach, the distribution charge would be $1.16 per kW, as compared to the next highest average delivery charge of $0.76 per kW (AmerenCIPS) as shown on IIEC Ex. 1.0, Fig. 2 at 10).

For the reasons stated above, IIEC's recommendation to increase or decrease rates for the over 10 MW customers served at standard <u>and</u> high voltage in proportion to the increase or decrease in ComEd's overall revenue requirement, should be adopted. IIEC's recommended language for modification of the Proposed Order in this regard is contained in Appendix A.[9]

## CONCLUSION

For the reasons stated above, IIEC's proposed modifications of the Proposed Order should be adopted.

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[9]Please note that language in the Very Large Load section of the Proposed Order will require modification to reflect adoption of IIEC's position. These conforming changes are shown under the modification for Exception 7 in Appendix A as well.

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Respectfully submitted,

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