STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

CENTRAL ILLINOIS LIGHT COMPANY	:	
d/b/a AmerenCILCO	:	
	:	No. 06-0070
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY	:	
d/b/a AmerenCIPS	:	
	:	No. 06-0071
ILLINOIS POWER COMPANY	:	
d/b/a AmerenIP	:	
	:	No. 06-0072
Proposed general increase for delivery services	:	(Consolidated)
(Tariffs filed December 27, 2005).	:	

REPLY BRIEF ON EXCEPTIONS OF THE
ILLINOIS INDUSTRIAL ENERGY CONSUMERS

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REPLY BRIEF ON EXCEPTIONS OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS

I.

INTRODUCTION AND SUMMARY OF POSITION

The Illinois Industrial Energy Consumers ("IIEC"), will respond to certain positions and arguments made by the Citizens Utility Board ("CUB"), the Illinois Commerce Commission Staff ("Staff"), and Illinois Power Company d/b/a AmerenIP ("AmerenIP"), Central Illinois Light Company d/b/a AmerenCILCO ("AmerenCILCO"), and Central Illinois Public Service Company d/b/a AmerenCIPS ("AmerenCIPS") (collectively the "Ameren Companies" or "Ameren"), in their respective Briefs on Exceptions ("BOE") to the Proposed Order of October 4, 2006 ("Proposed Order" or "PO"). IIEC's failure to address any specific argument or the position of any specific party in this Reply Brief on Exceptions ("RBOE") should not be taken as an endorsement or acceptance of that position unless otherwise expressly stated herein.

Specifically, IIEC will respond to and oppose CUB's exceptions to the Proposed Order as they relate to the average and peak ("A&P") method for allocation of demand-related distribution costs; CUB's exception to the Proposed Order's appropriate rejection of CUB's revenue allocation based on class risk differentials; Staff's recommended modifications to the Proposed Order setting forth new proposals for implementation of the revenue allocation based on a flawed A&P analysis by CUB; Staff's proposals for modification of the Proposed Order to reflect Staff's new proposals for implementation of its recommendation to have DS-4 customers participate in the subsidy of DS-1 customers; certain Staff proposals for modification of the Proposed Order to reject IIEC witness Gorman's return on equity analysis; and certain elements of Ameren's Brief on Exceptions as it related to use of the A&P method and whether DS-4 customers should share any subsidies created by the Proposed Order.

IIEC sets out its arguments below. The captions in IIEC's Reply Brief on Exceptions are based on the captions in the Proposed Order.

II.

ARGUMENT

VI. Rate of Return

E. Cost of Common Equity

In its Brief on Exceptions, Staff objects to the Proposed Order's reliance on both IIEC's and Staff's return on equity estimates to develop its recommended return on equity finding. Based on its criticisms of IIEC's return on equity analyses, Staff recommends that IIEC's return on equity estimates not be considered in developing the Final Order's allowed return on equity ROE. However, Staff's challenges to IIEC witness Mr. Gorman's analysis are flawed and do not justify any diminution of the Commission's confidence in IIEC's cost of equity estimate. Staff's criticism of IIEC's analyses and Staff's recommendation to exclude IIEC's estimate from the Commission's return on equity determination should be rejected.

Staff's Brief on Exceptions does not appear to dispute the validity of Mr. Gorman's analytical models or procedures. (*See*, Staff BOE at 22-26). This implicit support is not surprising, since fundamental elements of IIEC's and Staff's development of their DCF and CAPM cost of equity estimates are substantially the same. Staff objects only to Mr. Gorman's choices of input data for those analyses -- specifically, Staff criticizes his use of average stock prices in his DCF analysis, and his alleged reliance on historical data in deriving the risk premium for his CAPM study. (Staff BOE at 23).

In addition, Staff points to three proceedings, where Staff asserts the Commission rejected the use of historical data to support a return on equity estimate, as a basis for its objections. (*Id.* at 23-24).

Staff's factual premises are incorrect, its arguments are substantively flawed, and the cited Commission decisions are inapposite. Mr. Gorman's return on equity recommendations were not based entirely on historical data. His DCF analysis and his CAPM analysis incorporated historical data, current market capital costs, and forward-looking estimates of the utility's cost of capital. The cases on which Staff relies are both distinguishable and superceded by a more recent decisions on nearly identical analyses. For these reasons, which are discussed in greater detail below, Staff's recommendation to exclude IIEC's cost of equity estimate from the Commission's determination of an appropriate return should be rejected.

First, while Mr. Gorman used average prices to construct the current yield on his proxy utility group for his DCF model, that was only a starting point. Contrary to Staff's suggestion that this was the sole basis for his estimate, Mr. Gorman validated his DCF result by comparing that dividend yield to forward-looking and current market interest rates. (Gorman Corr. IIEC Ex 3.0 at 21:442-23:494). Thus, he acted affirmatively to assure that his DCF return result reflected today's capital market costs and rational investor expectations.

Second, Mr. Gorman's CAPM analysis reflected not only historical market returns, but forward-looking estimates of the market-required return. (Gorman Corr. IIEC Ex 3.0 at 28:611-29:617). One of Mr. Gorman's CAPM return estimates was based on historical data. A second CAPM study was based on forward-looking estimates of the market return on equity. This second CAPM return premium was modeled in a way very similar to Staff's CAPM return estimate. The primary difference between IIEC's forward-looking CAPM return estimate and Staff's estimate is that the IIEC expected (forward-looking) return used a "risk premium study." Staff relied instead on a "DCF" study. (*Cf.* Freetley, Staff Ex. 4.0 at 16:283; Gorman IIEC Ex. 3.0 at 28:611). Mr. Gorman's CAPM methodology was not challenged by any of the cost of equity experts in the case. (*See*, Staff BOE at 23).

Additionally, Staff does not mention Mr. Gorman's second forward-looking risk premium study, which was based on current interest rates and projected interest rates. This forward-looking study was incorporated in Mr. Gorman's risk premium analysis and supports his CAPM estimate. Staff has failed to recognize that this analysis, while relying on some historical data, was based primarily on current and projected interest rates, reflecting current and projected capital market costs. (Gorman Corr. IIEC Ex 3.0 at 25-26).

Staff's criticisms fail to acknowledge the totality of IIEC's return on equity analyses and estimates. Contrary to the suggestions of Staff's brief, Mr. Gorman's return on equity estimates were not based solely on historical data. Rather, his broadly based analyses – both DCF and CAPM – provided the Commission with a wealth of information concerning historical data, current observable interest rates, and projected capital market costs for the period that the rates determined in this proceeding will be in effect.

Staff's discussion of prior Commission decisions has not provided any evidence -- indeed does not even allege -- that the cases in which the Commission rejected the use of historical data involved multi-faceted cost of equity analyses like those Mr. Gorman used in this case. Nor did Staff show that any of the historical studies in those cases had been validated with current and projected capital market costs. The fact that IIEC's analyses did not rely solely on historical data decisively distinguishes them from the ones rejected in the cases cited by Staff.

The Commission itself has recognized the significance of that difference. The Commission accepted Mr. Gorman's analysis in its Order in the recent Commonwealth Edison DST rate case. (Commonwealth Edison Company, ICC Dkt. 05-0597, Order, July 26, 2006 at 153, 155). Moreover, in that case, where the Commission also used both IIEC's and Staff's return on equity estimates to develop an allowed return, Staff did not raise these ill-founded objections. (*Id*. at 155). Staff's position here is inconsistent with its position concerning the substantively identical analysis in that proceeding.

For these reasons, the Commission should reject (a) Staff's criticism of IIEC's cost of equity estimates, (b) Staff's recommendation to exclude IIEC's estimates from the Commission's development of Ameren's allowed return, (c) Staff's assertion that prior Commission decisions support its criticism of IIEC analyses, and (d) Staff's proposed language changes relating to IIEC's cost of equity estimates. The Commission's Final Order, like the Proposed Order, should endorse a return on equity recommendation based equally on the Staff's recommendation, and IIEC witness Mr. Gorman's recommendation.

VII. Rate Design

C. Cost of Service Issues

2. COSS Allocation Factor

a. Response to CUB

CUB appears to object to language in the Proposed Order recognizing that there are physical differences between the electric and natural gas industries. (CUB BOE at 16). CUB appears to be objecting to the Proposed Order's inference that differences between the gas industry and the electric industry may justify the use of a factor for allocation of demand-related distribution costs in the electric industry different from the allocator used for the allocation of gas transmission and distribution mains in the gas industry.

Although CUB admits there are physical differences, CUB argues these physical differences are "matters of engineering"[1] that are unrelated to the allocation of the cost of either electric distribution systems or transmission and distribution mains for a gas utility. (CUB BOE at 16). CUB's argument has unintentionally identified the exact reason why the differences are, in fact, relevant. As CUB noted, the allocation methodology it recommends allegedly recognizes the role that year-round demands (energy use) play in "shaping transmission and distribution costs." (*Id.* at 15). '

Therefore, presumably, CUB agrees that the allocation methodologies must have some realistic relationship to the design and construction (shaping) of the electric distribution system. The design and construction of the electric distribution system are based upon the functions the distribution system is intended to serve. If distribution systems are designed to serve different functions, this will affect the establishment of cost responsibility among the customer classes depending on their relationship to those functions. Accordingly, the specific function served will impact the cost allocation methodology (which is intended to reflect cost causation). The system of gas transmission and distribution mains is engineered and built to serve some functions different from those served by the electric distribution system. One of the primary differences is the ability to store natural gas within those mains and the inability to store electricity on the distribution system wires. Thus, in evaluating the use of the A&P allocator, used for gas transmission and distribution mains, for the allocation of demand-related

[1]CUB fails to explain why "matters of engineering" are not relevant factors in the cost of the distribution system infrastructure. It is precisely the "matters of engineering" and design that determine the capacity of the system and ultimately the cost.

distribution costs in the electric industry, one must give consideration to the different functions of these two kinds of systems.

It is simply illogical to say on one hand that an allocator must reflect cost causation, and on the other hand, that the design and engineering of the electrical distribution system is irrelevant to the determination of the appropriate allocator. This specious argument illustrates the fundamental flaw in the CUB approach, which is the proposal to use an allocator that bears no relationship to how the electrical distribution system is engineered or designed for the Ameren Companies.

The record here demonstrates that the Ameren electrical distribution system is engineered and designed to meet each customer's or group of customers' maximum demand whenever it occurs. The evidence here shows that the cost of the system is driven by the capacity of the system to meet those multiple demands. (Difani, AmerenIP Ex 9.0 at 8:174-176; AmerenCILCO Ex. 9.0 at 8:174-176; AmerenCIPS at 8:174-176). The record also shows there are differences between the system of natural gas transmission and distribution lines as compared to electric distribution lines, not the least of which is the inability to store electricity (as compared to natural gas). Under these circumstances, the Commission should reject the use of the A&P method in this case, as it did in the most recent ComEd delivery service case. (Commonwealth Edison Company, ICC Dkt. 05-0597, Order, July 26, 2006 at 172).

CUB also places great emphasis on the fact that the Commission adopted the A&P method in a case involving Northern Illinois Gas Company d/b/a Nicor in Docket 04-0779 (the "Nicor case") more than two years ago. CUB continues to ignore the fact that the Commission adopted the use of the non-coincident peak methodology in the most recent Ameren Companies' delivery service cases for electricity and in the most recently completed Commonwealth Edison Company delivery service case referenced above. The adoption of the A&P method in the Ameren case would establish a fundamental difference in the rates for delivery service customers in northern Illinois as compared to those in southern Illinois. ComEd rates would reflect the use of the NCP method, while Ameren's rates would reflect the use of the A&P method.

At this stage in the development of the competitive market for electricity in Illinois, customers should not be required to deal with this unwarranted difference in rates for delivery service tariffs. They need not do so. The record here does not require it. The record in support of the A&P method in this case is no more fully developed than the record in the ComEd case. The Commission rejected the use of the A&P method for that very reason in the ComEd case. It should do so again in this case.

IIEC identified important differences between the Nicor case and this case. (IIEC BOE at 25-26). CUB's reliance on the decision in the Nicor natural gas case is misplaced. The Commission should give no weight to the Nicor case in resolving this issue.

The Commission should reject CUB's recommended modifications to the Proposed Order. There are differences between the gas and electric industry which justify the continued use of the NCP method in this case.

b. Response to Staff

Staff notes that the Proposed Order concludes that the A&P method is the appropriate means of allocating demand related distribution costs. (Staff BOE at 35). Staff also notes that the Proposed Order recognizes that the record does not contain a reliable cost of service study implementing the A&P method. (*Id.*). Therefore the Staff reasons it is necessary for the Proposed Order to specify the manner in which delivery service rates should be set. (*Id.*). Staff's entire argument demonstrates a substantial flaw in the Proposed Order's adoption of CUB's recommended use of the A&P allocator for allocation of demand related distribution costs. Because there was no competent A&P cost of service study, there is absolutely no evidence of the impact on customer classes of applying such a methodology other than CUB's acknowledgment that the A&P allocator will shift revenue requirements from the residential to the nonresidential classes (Thomas, CUB Ex. 2.0 at 308-310). To implement the Proposed Order's conclusion, the Commission must construct a means for applying the A&P method out of whole cloth unsupported by the record in this proceeding.

Second, Staff's proposal constitutes an abandonment of its primary position in this case that the Company's cost of service study, which included the use of the NCP method, was appropriate for rate making purposes. (Harden, Staff Ex. 7.0 at 3:60-64). It is not clear why the Staff abandoned that principled position in its Brief on Exceptions and now supports a revenue allocation different from the one supported by its principal cost of service witness Ms. Harden.

Third, Staff's suggestion ignores substantial error in the CUB analysis and its application of the A&P method. Staff notes there is a difference in the calculation of the Ameren revenue requirement between CUB and Ameren, which the Staff identifies as significant. (Staff BOE at 35). Staff calculates the revenue difference to be approximately $19 million. (*Id.* at 36). However, the record in this case shows that the difference is substantially greater than $19 million and, therefore, even more significant than the Staff suggests to the Commission. The revenue difference for Ameren CILCO alone is $12,331,000; the revenue difference for AmerenCIPS is $7,776, and the revenue difference for AmerenIP is $23,287,000.[2] (*See*, CUB Ex. 4.2). Thus, the difference is $43 million opposed to the $19 million incorrectly calculated by Staff

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[2]These figures are calculated by totaling the NCP and A&P revenue requirements for AmerenCILCO, AmerenIP and AmerenCIPS for each rate class shown in CUB Ex. 4.02 and subtracting the A&P revenue requirements from the NCP revenue requirements. (*See* Appendix A).

These differences are an indication that there is something radically wrong with CUB's analysis. As CUB witness Thomas testified, in the context of CUB's overall revenue allocation recommendations for Ameren CILCO:

> Q. Now, are you saying you don't know whether or not your proposal would result in allocation of 25 percent revenue requirement – of the total revenue requirement to a particular class, or ten percent or 30 percent or 50 percent, as I thought perhaps it showed, as you sit here today?
>
> A. As I sit here right now, no.
> (Thomas, Tr. 976-977).

CUB witness Thomas subsequently admitted that he would not be surprised if the same type of problem appeared with regard to his other proposed allocations for AmerenIP and AmerenCILCO and that perhaps his analysis was done incorrectly. (Thomas, Tr. 977). One would have to fix the numbers in order to show the correct allocation. (*See*, Thomas, Tr. 976)

Mr. Thomas' testimony demonstrates why it is important to consider and have competent evidence of, customer impacts. While Mr. Thomas' testimony addressed CUB's overall revenue allocation proposals, those proposals included application of the A&P method. The proposals obviously contained errors and the disparities in resulting revenue allocations were significant. For example, under CUB's overall approach, DS-4 customers in the AmerenCILCO service territory would have been allocated roughly 50% of the Company's entire revenue increase, which even Mr. Thomas agreed was arguably an unreasonable result. (Thomas Tr. 976-977).

This demonstrates why it is important for the Commission to have competent evidence on customer impacts and cost of service before changing the NCP method for allocation of demand-related distribution costs that (i) has been historically used by the Commission for the allocation of such costs,

(ii) has been consistently used in every electric delivery service rate case since the adoption of the Customer Choice and Rate Relief Law of 1997 (220 ILCS 5/16-101 et seq), (iii) was adopted in the most recent ComEd delivery service case over the A&P method, and (iv) was supported by the Staff's own cost of service witness in this case.

The Staff seems to consider the fact that CUB and the Ameren Companies have different total revenues is the only problem with the CUB proposal. In fact, the difference in total revenues is significantly more than Staff has suggested to the Commission and is just a symptom indicating that something is radically wrong with CUB's approach. Staff's proposal ignores basic cost of service analysis problems and simply proposes adopting CUB's obviously flawed results adjusted by a ratio to get to a final result. The Staff is apparently willing to ignore customer impacts when it comes to larger customers and apply the results of a faulty study to allocate revenue responsibility. The Commission should not adopt Staff's current proposal. The Commission should adopt the recommendation of Staff witness Harden endorsing the use of the NCP method in the context of the Ameren Companies embedded cost of service study.

Staff suggests that the Commission could have Ameren rerun cost of service studies using the A&P method. However, this would be done outside of the evidentiary record in this case. Parties would not have the opportunity to conduct discovery or cross-examination on the results of such a study. As can be seen from the cross-examination of CUB witness Thomas, on the results of his cost of service study and the allocation of the revenue requirement resulting therefrom, such studies can, in some circumstances, contain substantial errors. (*See*, Thomas, Tr. 965-977). Indeed, CUB's original analysis contained an error in the calculation of CUB's A&P allocator, which CUB purportedly corrected in its rebuttal testimony. (*See*, Difani, Ameren Ex. 19.0 at 4:87-94; Thomas, CUB Ex. 4.0 at 6:129-137).

Because CUB presented such evidence in the context of the record in this proceeding, the parties were able to review the CUB proposal and identify the errors contained therein and address them through cross-examination. The Staff's approach, because would be extra record, prevents parties from having the same opportunity to challenge the validity or accuracy of Staff's approach. It, therefore, should be rejected.

Finally, the Staff suggests that if neither approach is desirable, the Administrative Law Judges ("ALJs") on their own, should simply develop a methodology and describe the same in a revised Proposed Order. This rather unique approach suffers from the same defects as the approach discussed immediately above. It is unclear how the parties would have a chance to explore and respond to any methodology the ALJs should happen to develop on their own in the context of this proceeding. It is equally unclear whether or not such a methodology would be based on competent evidence in the record. This approach should be rejected by the Commission as well.

c. Response to Ameren

The Ameren Companies continue to support application of the non-coincident peak method ("NCP") for allocation of demand-related distribution costs. They correctly suggest that because of CUB's faulty impact analysis, the Commission cannot know what the just and reasonable rate is for nonresidential customers. (Ameren BOE at 6). Indeed, as noted above, the Staff's proposals to modify the Proposed Order in this area are an explicit recognition of the deficiency in the record in this proceeding. IIEC agrees with Ameren that the NCP method is the appropriate method for allocation of demand-related distribution costs based on this record.

4. Interclass Subsidization

a. Response to Staff

Staff's exceptions to the Proposed Order in this area also demonstrate a substantial flaw in the Proposed Order's decision to require DS-4 customers to share in any subsidy to DS-1 customers.[3] First, IIEC notes that Staff has identified another problem area related to the use of the A&P method in this case, especially the use of the A&P method in conjunction with Staff's eleventh hour recommendation that DS-4 customers be required to help subsidize DS-1.[4] Staff suggests that it may not be necessary for DS-4 customers to help subsidize DS-1 customers in the AmerenCILCO service territory because application of the A&P method may eliminate the need for such a subsidy. (Staff BOE at 38). Staff's statement clearly demonstrates why it is inappropriate to adopt the A&P method in this case and to create interclass subsidies, and in particular, to require DS-4 customers to share in such a subsidy based on the record in this proceeding. The Staff cannot tell, based on the record in this proceeding, whether any "rate relief for DS-1 customers" is even necessary under the Proposed Order's overall cost allocation and revenue allocation approach. This is simply because there is no competent evidence in the record to explain exactly how such approaches can be implemented, what their ultimate impact might be, and ultimately whether DS-1 customers require rate relief. The Staff goes on to make a specific suggestion on how DS-4 customers might be required to share in the subsidy to DS-1

[3]As noted in IIEC's Brief on Exceptions, IIEC disagrees with the concept of creating any subsidies in delivery service rates. (IIEC BOE at 31-32). IIEC will not repeat those arguments here and will focus on Staff's recommendation for implementing the Proposed Order's erroneous conclusion that DS-4 customers should share in any subsidy for DS-1 customers.

[4]At no point in the evidentiary record of the case did Staff make such a proposal or position known. Staff agreed with Ameren's revenue allocation proposal that included no interclass subsidy by the DS-4 class. (Harden, Staff Ex. 7.0 at 4:66-72, 7-8:130-164). Even Staff witness Luth did not actually make such a specific proposal in testimony. (*See* Luth, Staff Ex. 19.0).

customers even though Staff notes earlier that in some instances, such a subsidy may not even be justified.

Staff goes further to suggest that if its proposal is not acceptable, then ALJs again come up with their own approach, which no party in this proceeding will have a chance to challenge or oppose because it will be outside the evidentiary record in this proceeding. (*See* Staff BOE at 39).

Staff then argues that the Proposed Order is not clear on the amount of rate relief necessary or desirable for DS-1 customers. (*Id.*). This, of course, is because the record itself is hugely deficient in this area as well and, thus, the Proposed Order could not make clear the amount of rate relief that was necessary or desirable for DS-1 customers. In spite of this record deficiency, the Staff boldly suggests a means for increasing the revenue assigned to each Ameren rate class on the assumption that the DS-1 rate class is entitled to some unknown level of rate relief from DS-4 customers, having already admitted that at least in some circumstances, the DS-1 customers may not be entitled to any rate relief at all.[5] Staff's recommendations on revenue allocation have not been tested in the record in this proceeding, and as can be seen from cross-examination of CUB's revenue allocation proposal, one cannot simply assume that the method proposed is fair or equitable or leads to desirable results. The Staff proposals are in direct conflict with those of its own witness Ms Harden, who adopted the revenue allocations recommended by the Ameren Companies with some alteration of the proposed revenue allocation for DS-2 and DS-3 in the case of AmerenCILCO. (*See,* Harden, Staff Ex. 7.0 at 4:66-72, 7-8:128-164; Harden Staff Ex.

[5]As a matter of fact, Staff witness Harden testified that the AmerenIP and AmerenCIPS revenue allocations did not create rate shock for the DS-1, DS-2 and DS-3 rate classes and suggested in the case of AmerenCILCO that the only adjustment to the revenue allocation proposed by the Company was to adjust the revenue allocation between DS-2 and DS-3. (Harden Staff Ex. 18.0 at 2:31-35 and 3-4:64-67). This further demonstrates there is no need to have DS-4 customers share in the subsidy for DS-1 to present rate shock to DS-1, DS-2 and DS-3.

18.0 at 2:31-35 and 3-4:64-67). Furthermore, since the results desired are not specified, (*i.e.*, the level of rate relief to be granted to DS-1 customers) evaluation of the Staff's proposal, even at this late date in the case, in the context of these briefs is really impossible.

Indeed, one of the most troubling aspects of the Staff's Brief on Exceptions is the language it actually recommends be incorporated into the Proposed Order to address the deficiencies in the Proposed Order's conclusions on cost and revenue allocation. Staff ultimately recommends that the Proposed Order be modified to adopt the worst of both worlds from the point of view of nonresidential customers, such as DS-4 customers. Staff recommends language that would shift costs under the A&P approach to nonresidential customers and require DS-4 customers to participate in any subsidy for DS-1 customers, regardless of the fact that such a subsidy may no longer be needed in certain instances. (*See*, Staff BOE at 39-40, recommending language which would provide DS-1 customers with rate relief beyond even the amounts suggested by Ameren, without the benefit of knowing or developing on the record the amount of rate relief desirable in the first instance and without regard to the impact of its recommendation on any other customer class.) Staff's proposal should be rejected.

In sum, Staff's attempts to support the validity of the Proposed Order's adoption of its recommendation to have DS-4 customers share in a subsidy to DS-1 customers through proposals that are extra record, fail to consider the impact on other customers, implement subsidies where none may be needed and are in conflict with recommendations made by Staff's own cost of service witness. The Commission should, carefully consider the testimony of Staff witness Harden, who clearly supported the Company's cost of service study which included the NCP method) and the Company's proposed revenue allocation. That allocation did not require DS-4 customers to share in subsidies to DS-1 customers. Staff's abandonment of that position in favor of an ill-defined and unsupported recommendation, made in the briefing stages of this case, to require DS-4 customers to share in any subsidy to DS-1 customers should be rejected.

b. Response to Ameren

IIEC notes that Ameren opposes the Proposed Order's recommendation to require DS-4 customers to share in any subsidy to DS-1 customers. (Ameren BOE at 8). Ameren notes that given the Commission's determinations in other areas of the Proposed Order, subsidies to DS-1 customers in certain instances may no longer be necessary. (Ameren BOE at 9). While IIEC continues to oppose the creation of the subsidies for any class in the first instance, it certainly agrees with Ameren's criticism of the Proposed Order's adoption of the Staff's recommendation to require DS-4 customers to share in any subsidy to DS-1 customers. Ameren also makes extra record recommendations on how to implement the Proposed Order's finding that DS-4 customers should share in the subsidy. (See Ameren BOE at 11-12). These proposals do not have the benefit of evidentiary support and should not be adopted for many of the same reasons discussed above in the response to Staff proposals on the same subject. At least Ameren attempts to access the impacts of its proposals and comment accordingly. Staff on the other hand, gives no consideration to the impacts of its proposals.

5. Relative Class Risk

CUB takes exception to the Proposed Order's correct determination to reject CUB's class risk adjusted revenue allocation. (CUB BOE at 17-20). CUB's exception should be disregarded and rejected for several reasons.

First, CUB argues that class risk differentials should be recognized and that based on those differentials a 90% multiplier should be used to allocate the revenue requirements of the Ameren Companies. (CUB BOE at 17). However, the record in this case contains neither mathematical nor empirical evidence to support such a multiplier. (*See,* Chalfant, IIEC Ex. 5.0 at 23:467-480). Indeed, CUB's own witness stated that no one has ever been able to calculate the "risk differential" upon which CUB's proposal is based. (Thomas, Tr. 964). Indeed, this very approach was rejected in the most recent Commonwealth Edison delivery service rate case because of the lack of this empirical evidence. (*See*, <u>Commonwealth Edison Company</u>, ICC Dkt. 05-0597, Order, July 28, 2006, at 176). The Proposed Order correctly rejects the use of the class risk approach for allocation of revenues in this case. CUB's objection to the Proposed Order's conclusion should be rejected.

Second, CUB suggests that in spite of the fact that no one has been able to effectively quantify a class risk differential (and thereby demonstrate that such differential actually exists) it is inappropriate to simply assume that the class risk differential does exist. (CUB BOE at 19). CUB's argument here is equivalent to arguing that simply because no one has been able to effectively demonstrate the existence of Santa Claus, it is inappropriate to simply assume that Santa Claus does not exist. CUB argues elsewhere in its Brief on Exceptions, that the Commission should recognize that distribution of interclass revenue requirements is a matter of "sound business judgment." (CUB BOE at 17). It is difficult to see how allocation of the revenue requirement among the customer classes in this case can be considered "sound business judgment" if it is done on the basis of a class risk differential that has never been demonstrated to exist.

Elsewhere in its BOE, CUB also argues that rate design requires the use of "pragmatic adjustments and Commission discretion." (CUB BOE at 17). However, even if true, the use of pragmatism and discretion require some basis in fact, lest they be considered arbitrary. In the face of the fact that a class risk differential has never been demonstrated to exist, it is difficult to see how application of such a risk differential to justify particular revenue requirement allocations can be considered anything other than arbitrary. Thus, CUB's recommended modification should be rejected.

Third, even though the existence of a class rate of return differential has never been identified or quantified, CUB's assumption of the existence of such a class differential has been adequately refuted. CUB's assumption is based on the conclusion that there is less predictability in industrial and commercial sales. (*See* CUB Initial Br. at 121). Ameren presented evidence that the industrial classes actually have a higher predictability and stability of sales to Illinois utilities than the residential class. (Jones, Ameren Ex. 41.0 at 7-8). Thus, CUB's assumption that "Santa Claus exists" is incorrect.

Furthermore, CUB's approach, followed to its logical conclusion, suggests that CUB's revenue allocation is a self-fulfilling prophecy, as CUB arbitrarily shifts more and more revenue to the largest customers, these customers will either leave the system or reduce their consumption of electricity, thereby making them even more risky to serve in the future under CUB's theory and justifying even larger revenue increases to them in the future.

Indeed, the arbitrariness of CUB's position is demonstrated by the fact that it apparently was totally unaware that its overall revenue allocation recommendations in this case would allocate 50% of the entire rate increase for AmerenCILCO to the DS-4 class. (Thomas, Tr. 977). CUB has given absolutely no consideration to the impact of its proposals on other customer classes. It is in this instance it proposes a revenue allocation methodology which is based on class risk differentials that have never been shown to even exist, on the rather unique theory that use of such a methodology is justified by desires to mitigate rate increases for certain classes, thus, apparently abandoning its suggestion that revenue allocation needs to be based on "sound business judgment."

Furthermore, neither CUB nor Staff nor any other Intervenor witness has actually quantified the amount of rate relief or mitigation to which the residential class should be entitled. As demonstrated above, CUB's own revenue allocation recommendations and the analysis upon which it was based has been shown to be fundamentally flawed. CUB's desire to reduce rate shock for its constituents, does not address or explain why it is not appropriate to consider rate shock for other customer classes as well. CUB's approach to revenue allocation through the class risk differential approach was properly rejected by the Proposed Order under these circumstances and should be rejected by the Commission as well.

III.

CONCLUSION

For the reasons stated above, the recommendations of Staff respecting the use of IIEC's return on common equity analysis, the recommendations of Staff and of CUB on the use of the average and peak methodology and revenue allocations should be rejected.

Respectfully submitted,

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