STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
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Proposed General revision of rates, restructuring and price unbundling of bundled service rates, and revision of other terms and conditions of service	:	No. 05-0597 (On Rehearing)

COMMONWEALTH EDISON COMPANY'S REPLY BRIEF ON REHEARING

November 21, 2006

TABLE OF CONTENTS

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INTRODUCTION

All parties have now had their opportunity to submit testimony and other evidence on rehearing and provide to the Commission additional reasons to modify the July 26 Order (the "Order") on issues as to which the Commission granted rehearing. With only one or two narrow and limited exceptions**,** the only party who submitted anything new to the Commission was ComEd. ComEd provided that detailed and specific evidence concerning the factors leading to increases in Administrative & General ("A&G") expenses, alternative methods of recognizing that the $803 million pension contribution was not cost-free, and an estimate of the subsidy created by the Order's Rider GCB ruling. In addition, ComEd, along with the Illinois Industrial Energy Consumers ("IIEC") and the United States Department of Energy ("DOE") negotiated and have presented a compromise package stipulation that provides the Commission a record basis upon which to resolve several of the most controversial issues presented by this case.

For the most part, however, the rehearing ordered by the Commission to consider new evidence and arguments was used simply as an opportunity for all other parties, including Staff, to repeat and belabor arguments and positions that had already been rejected, without any effort to present to the Commission new or additional reasons that might support modification of the Order. Indeed, in some ways the issues the Commission invited the parties to address on rehearing were made more complicated than necessary, rather than clarified. This is most notable in the areas of "functionalization" of General & Intangible Plant, increases since 2000 in A&G costs, and the pension contribution, as well as in the transparent efforts to support a subsidy that the Commission mistakenly concluded was required by the Public Utilities Act.

ComEd's evidence on rehearing was comprehensive, clear, concise and responsive to the Commission's requests and purpose in granting rehearing. ComEd is confident that a dispassionate and objective view of the evidence and the briefs leads to only one conclusion: that the resolution proposed by it, IIEC and DOE is fully supported by the record, is fair and equitable to all parties. This resolution should be adopted by the Commission to provide to ComEd, after ten years and billions of dollars in improvements that have enhanced service to all, at least a small measure of the rate relief to which it is entitled and of which it is badly in need.[1]

B.2. GENERAL AND INTANGIBLE ("G&I") PLANT

1-2. <u>General Plant and Intangible Plant - Functionalization and Amount</u>

Staff argues primarily that the Commission's ruling on General Plant and Intangible ("G&I") Plant functionalization is erroneous and should be revised because the Commission improperly reallocated the burden of proof to Staff and Intervenors and relieved ComEd of its burden. Staff Reh.Br. at 3-6. The Commission did not do so. The Order accurately finds: "The Commission is required to look thoroughly at each docket on a case by case basis. The record

[1] As ComEd stated in its initial rehearing brief, an order based on the package resolution would increase ComEd's revenue requirement $87.8 million above that authorized by the Order. Otherwise, ComEd is requesting an increase of $121 million above the $8.3 million authorized by the Order, an increase amply supported by the record. ComEd Reh.Br. at 5, 12.

established here by ComEd is supported by convincing evidence that the costs associated with general and intangible plant assets are reasonable." Order at 27 (emphasis added).

Contrary to Staff's argument, ComEd introduced extensive evidence that all of the G&I plant sought to be included in the delivery services rate base is used to support jurisdictional delivery services (the distribution and customer functions), as opposed to some supply or production function. Staff also makes inaccurate arguments about ComEd's use or non-use of a direct assignment methodology.[2]

a. Burden of Proof

ComEd acknowledges that it bears the burden of proof in this proceeding, a burden which it has met. Accordingly, in the initial phase of this case, ComEd presented highly detailed, uncontradicted evidence that all G&I plant sought to be included in rate base - - including the $304 million of such plant that Staff seeks to exclude - - is used and useful to perform the distribution and customer functions, and does not support any supply or production function. *E.g.*, Hill Dir., ComEd Ex. 5.0 Corr., 9:179-180, 9:183-188, 10:211-214, 11:221-226, 11:231-13:282, 18:372-22:470; ComEd Ex. 5.1, Scheds. B-1, B-2.1, B-4, B-5, and C-12; ComEd Ex. 5.2, work papers WPA-5, WPB-1, WPB-2.1b, WPB-5, and WPC-12; Costello Dir., ComEd Ex. 3.0, 19:395-21:443; DeCampli Dir., ComEd Ex. 4.0, 1:10-3:48, 16:341-20:413, 37:770-56:1168; ComEd Ex. 4.3 Corr.[3]. That evidence was extensive and specific and far exceeded what ComEd

[2] CCC, CES, and IIEC also have briefed this subject, but they have shown no reason to alter the Order's findings here. They simply repeat their claims from the first phase of this case, without having presented any new facts on rehearing. Their claims were shown to be unsupported and incorrect, and they rightly were rejected by the Order.

[3] *See also, e.g.*, Costello Reb., ComEd Ex. 13.0 Corr., 3:54-63, 9:173-187, 26:586 - 31:694; Hill Reb., ComEd Ex. 19.0 Corr., 14:280 - 25:554 and Sched. 3, 4, 5, 6, 7, 8, and 9; Heintz Reb., ComEd Ex. 25.0, 5:88-97; Costello Sur., ComEd Ex. 30.0, 1:21-25, 2:38 - 4:81, 12:248 - 14:289, 22:442 - 23:452; Hill Sur., ComEd Ex. 36.0 Corr., 14:291 - 23:523 and Schedules 5, 6, and 7.

was required to proffer to establish a *prima facie* case which, if no contrary evidence were submitted, would sustain ComEd's burden of proof.

> In proceedings before the Commission, once a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a *prima facie* case. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).* The burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).*

Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 327 Ill. App. 3d 768, 776 (3d Dist. 2002).

In fact, no contrary evidence was submitted. Neither Staff, IIEC nor any other Intervenor submitted any evidence that any G&I plant in the proposed rate base was used for anything other than the distribution and customer functions. The Order's statement, upon which Staff rests for its claim that the burden of proof was shifted, simply reflects the Commission's accurate assessment that neither Staff nor IIEC introduced any evidence that controverted the case made by ComEd. The Commission further observed in its Order that Staff's position seeking to exclude the $304 million was based entirely on an alleged inconsistency with the Commission's prior order in Docket 01-0423. Order at 21-22. Staff has admitted that the parties who were granted rehearing on this issue presented no new facts to the Commission. Lazare, Tr. 208:6-10, 208:21-209-10. In short, Staff concedes that it introduced <u>no evidence</u> that tended to contradict ComEd's showing that the entire amount of G&I plant sought to be included in rate base was used and useful in support of the distribution and customer functions. Far from shifting the burden of proof, the Commission, in the Order, simply noted the obvious - - that Staff had produced absolutely no evidence that suggested any particular assets served a supply or production function.[4]

As a matter of law, ComEd's uncontradicted evidence cannot be disregarded. "Where the testimony of a witness is neither contradicted, either by positive testimony or circumstances, nor inherently improbable, and the witness has not been impeached, that testimony cannot be disregarded by the trier of fact." *Bazydlo v. Volant,* 164 Ill.2d 207, 215 (1995); *see also, Thigpen v. Retirement Bd.,* 317 Ill.App.3d 1010, 1021 (1st Dist. 2000). Had Staff introduced its own "positive testimony" on the use to which the assets were put, ComEd may have been required to produce additional evidence in order to sustain its burden of proof. But mere disbelief, incredulity, or intuition[5] is not enough to require ComEd or any other utility to produce additional evidence.

b. <u>Direct Assignment</u>

Staff's argument about the alleged defects in the "direct assignment" study is a red herring. In the 2000 test year used in Docket 01-0423, ComEd was an integrated company engaged in both delivery services and production. Now, however, ComEd is a "wires" company,[6] as Staff's own witness admitted it has been since 2001,[7] and ComEd has no

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[4] Staff's citation of *Illinois Power Co.*, Docket 01-0432 (Order March 28, 2003), is misplaced. There, the Commission found that a utility had failed to prove that all of its assets supported the post-generation divestiture operations of the utility. Here, ComEd provided highly detailed, uncontradicted evidence that all of its post-generation divestiture G&I plant is used and useful to serve the distribution and customer functions, and does not serve any supply or production function, and that it had transferred out all of the G&IP that supported the production function. Staff just ignores those facts.

[5] *See, e.g.,* Lazare Dir., Staff Ex. 6.0 Corr., 5:109-113; 6:143-45 (ComEd fails to explain why such a "large" increase in G&I plant occurred); IIEC Reh.Br. at 5 (Mr. Chalfant felt there was "an intuitive relationship between G&I Plant and distribution plant."). Intuition is not evidence at all, much less "substantial evidence," as IIEC apparently claims. *Id.* Even if it were evidence, the Commission cannot accept it where, as here, direct evidence is in the record. Staff's complaint about a "142%" increase in G&IP also is grossly overstated and without merit. *E.g.*, Hill Reh. Reb., ComEd Ex. 60.0, 7:154 - 8:178.

[6] *E.g.,* Costello Reb., ComEd Ex. 13.0, 9:173-87.

production plant in rate base *E.g.*., Hill Reh.Reb., ComEd Ex. 60.0, 2:41- 7:153. All G&I plant that supported the production function was transferred out of ComEd in late 2000 and early 2001. *Id.,* at 3:57 - 4:67, 4:86-7:153. That is a reality no one can - - or does - - contest. This reality alone renders moot Staff's assertions that the method of direct assignment "remains unknown," or was done "off the record," or is "fundamentally flawed." Staff Reh.Br. at 8, 9, 10. The fact is, no direct assignment was needed with respect to any functional use other than transmission assets and distribution/customer assets, because ComEd uses its plant assets only for the delivery of electricity.[8] In other words, ComEd made the only correct direct assignment to the production function: zero. The contention that ComEd somehow skipped a step by not making a direct assignment of non-existent production plant to a non-existent production function is wrong.

Staff has failed to recognize that the uncontradicted facts demonstrate that all G&I plant ComEd seeks to include in rate base in this case support only the distribution and customer functions. ComEd's Initial Brief on Rehearing demonstrates why the Commission's Order in Docket 01-0423 -- Staff's sole support for the $304 million adjustment -- can no longer be relied upon, resting as it does on fundamentally erroneous assumptions that, whatever their merits at the time, actual data since have been shown to be incorrect.[9] Staff introduced no evidence at the

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[7] *E.g.*, Lazare, Tr. at 632:11-17, 643:12-13.

[8] Staff's complaint that the Order recognized that the general labor allocator, which Staff championed in the past, would have allocated even more G&IP to the distribution and customer functions (Staff Reh.Br. at 10-11) also is based on Staff's unwillingness to accept the fact that ComEd has not had a production function for over five years.

[9] Staff contends that ComEd "restored" G&I plant to its rate base. That is not true. In Docket 01-0423 and in the current case, Staff has never identified even one General Plant or Intangible Plant asset that supposedly supports any supply or production function. The Order in Docket 01-0423 did not do so, either. The Order in Docket 01-0423 simply used an estimate multiplied across the board. There is no asset that has been "restored" to rate base.

Staff also contends that the Commission has found direct assignment to be fundamentally flawed. That also is not true. The Commission consistently has found that direct assignment, where it is feasible, as it has been shown to be in this case, is the most accurate functionalization methodology. The Commission's Order in *Illinois Commerce Comm'n v. Central Illinois Light Co., et al.*, ICC Docket 99-0013 (Order October 4, 2000) at 44, stated: "As a hearing or on rehearing that undermines ComEd's showing, and the Commission's Order rejecting the proposed removal of $304 million of G&I plant from rate base should be sustained. This is no longer an allocation or direct assignment issue; Staff's estimate has simply been rendered moot by the facts, and has been shown to be wrong.

B.3. PENSION CONTRIBUTION

The debate on whether or not a pension asset exists as a regulatory matter or an accounting matter could likely continue for several more rounds without one side convincing the other. At this point in the proceeding, the debate does not need to be resolved.[10] The fundamental issue is whether the $803 million pension contribution had a cost to ComEd and if so, what portion of that cost should be reflected in ComEd's rates.

All parties who have expressed a view on the issue have accepted that ComEd's funding of the pension plan carried a cost. Staff Reh.Br. at 20, 22-23, AG Reh.Br. at 2, CCC Reh.Br. at 4; IIEC Reh.Br. at 6. Likewise, all parties who have expressed a view on the issue agree that the contribution has conferred a benefit on customers. Staff Reh.Br. at 20, 26, IIEC Reh.Br. at 6. Finally, a consensus appears to have been created that if ComEd is to be compensated for the

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general proposition, the Commission believes that direct assignment of costs is superior to the application of general allocators if the costs are suited to direct assignment and sufficient cost data is available to make direct assignments." The Order in Docket 01-0423 at 79, when discussing A&G expenses, expressly reaffirmed and quoted that language from the Order in Docket 99-0013.

[10] Although the pension asset debate need not be resolved, Staff has made a new argument on this issue that is without merit. Staff now concedes that ComEd properly accounted for the pension contribution under Generally Accepted Accounting Principles ("GAAP"), but makes the new argument that accounting guidance from FERC somehow suggests that the cost of the contribution should not be reflected in rates. Staff Reh. Br. at 16-17. This is incorrect. The FERC guidance is <u>accounting</u> guidance and simply does not address rate recovery. Moreover, Staff misinterprets the guidance by selectively quoting from it, ignoring language that makes clear that the delayed recognition feature of Statement of Financial Accounting Standards ("SFAS") 87 relates to "changes in the pension obligation and the <u>value</u> of assets set aside to meet these obligations." Staff Cross Ex. 1, attached FERC Guidance, at 2 (emphasis supplied). In other words, to the extent trust fund asset <u>returns</u> are better or worse than expected, the under- or over-performance should be recognized in pension expense under SFAS 87 on a delayed basis. The FERC guidance thus addresses the accounting for pension trust investment returns (changes in "value"), not recovery "on" investor-supplied funds for a pension contribution, which is the issue here. See Holdren Reh.Reb., ComEd Ex. 63.0, 6:125 – 7:138. If Staff's interpretation were correct, ComEd would not even have been able to recognize the contribution on its balance sheet under GAAP, even though Staff now agrees it was proper to do so.

benefit it has conferred on consumers and receive at least a portion of the cost it has incurred, Alternative 3 would be the appropriate measure of that compensation. Staff Reh.Br. at 12, AG Reh.Br. at 3-4, IIEC Reh.Br. at 6. Staff agrees that Alternative 3 "leaves ratepayers in no worse position than they would have been absent the pension prepayment." Staff Reh.Br. at 26. In fact, Alternative 3 results in a $5 million net benefit to customers because the savings reflected in rates outweigh the costs.

Accordingly, the Commission should, at a minimum, provide that ComEd's Alternative 3 be adopted and that it be granted recovery for a portion of the cost in incurred in making the pension contribution in the amount of $25.3 million

C.1.a <u>CES's Proposal To "Functionalize" The A&G Costs In Question To The Supply Function Should Be Rejected.</u>

CES' Initial Rehearing Brief argues, in effect, that the whole A&G debate is really nothing more than one of "functionalization," *i.e.,* that the $79 million in question are really supply-related costs and ComEd should simply adjust the Supply Administration Charge so that these supply-related costs can be recovered from supply customers.[11] In furtherance of this argument, CES attempts to create the dual impressions that (1) in Dkt. 01-0423 the Commission "functionalized the A&G Expenses in question . . . as supply costs," and (2) in the Order in this case the Commission disallowed $62 million of this amount on the grounds that ComEd had presented insufficient evidence supporting its attempt to "re-functionalize the A&G expenses to

[11] CES also argues (Reh.Br. at 11-12) that the Commission should adopt ComEd's "proposal" to refresh the data used to calculate the Supply Administration Charge ("SAC"). To be clear, this is not exactly a ComEd "proposal." ComEd does not agree that any of the G&I plant or A&G costs in question should be recovered in any manner other than through delivery service (or transmission) rates. ComEd is concerned that if such a large amount of costs must be recovered, through the SAC, the SAC in its present form is not capable of recovering those costs. It is only if those costs must be recovered only through the SAC that ComEd believes that the SAC must be updated to reflect that and other recent circumstances.

delivery services customers." CES Reh.Br. at 7, citing Order at 67-68. Both propositions are erroneous and misstate the record.[12]

More importantly, nothing in the record indicates that the $62 million in disallowed costs are supply-related. Instead, it is readily apparent that these costs cannot be considered supply-related. CES never suggests, for example, how $8.1 million in IT depreciation (part of the disallowed $62 million) could conceivably be supply-related. Although CES claims that Staff witness Lazare "explained" that $6.1 million of ComEd's $7.8 million of Sarbanes-Oxley compliance costs "is properly considered supply related," (CES Reh.Br. at 11), Mr. Lazare did not in fact provide any such "explanation." At the transcript page cited, Mr. Lazare offered only that it could be argued that ComEd's Sarbanes-Oxley costs were "excessive." Tr. 172:13-14. He did not, however, "explain" why $6.1 million of those costs were supply-related.

ComEd's supply function is at most a *de minimis* one from the standpoint of ComEd resources devoted to that function. CES, consisting of competing suppliers, obviously has two interests: (1) keeping delivery service charges as low as possible, and (2) loading costs onto the auction price to enhance their own ability to compete against that product. However, the only result will be prices that are higher than they should be for customers lacking viable competitive options. The Commission should not accept CES' recommendation.

[12] As to the first, CES cites Staff's Brief on Exceptions in this case, not the Order in 01-0423, and nothing in that Staff Brief characterizes the Order in Dkt. 01-0423 as disallowing any of the A&G expenses on grounds of functionalization. Indeed, in that Brief, Staff proposed language for the Order in <u>this case</u> to the effect that "[t]he Commission did not find any expenses that should be recovered through a Supply Administration Charge." Staff Br. Exc. at 41. Similarly, nothing in the Order in this case - - and certainly not the portions cited by CES - - suggests that the Commission disallowed any part of the $62 million in question on the basis that they were improperly functionalized.

C.3. ADMINISTRATIVE & GENERAL ("A&G") COSTS

a. Staff's Proposals To Disallow Any Part of the $62 Million A&G Expenses Sought By ComEd On Rehearing Should Be Rejected.

Staff's argument on A&G expenses mischaracterizes ComEd's presentation and then seeks to have the Commission deny recovery of A&G expenses on the basis of exactly the same type of improper analysis it wrongfully asserts ComEd conducted. Staff's recommendation should be rejected.[13]

First, Staff accuses ComEd of "break[ing] out isolated components of A&G expense and analyz[ing] them in isolation." Staff Reh.Br. at 38. That is emphatically *not* what ComEd did. Instead, ComEd presented a comprehensive analysis of each of the fourteen accounts comprising A&G expense, and detailed the factors that resulted in an increase or decrease in each such account since 2000. *See, e.g.,* ComEd Ex. 52.1.[14] In addition, ComEd presented that information in another form so that the Commission could better understand the specific drivers of the $79 million increase in A&G expenses since the last case. Ms. Houtsma's direct rehearing testimony identified and described those factors in detail. ComEd Ex. 52.0 Corr., 7:116-20:385; *see also id.* 4:73-6:111. This is not an "analysis" of "isolated" items, but an identification of the discrete factors that led to an increase in overall A&G expense provided because the Commission asked for just that kind of analysis. In its Order, the Commission stated that it was unable to evaluate ComEd's request without being able to see the individual expenses and encouraged ComEd in its rehearing petition to specify the increases in A&G expenses. Order at 50.

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[13] Other parties, such as CCC, simply parrot Staff's position on A&G costs without offering any additional evidence or analysis. CCC Reh. Br. at 5-8.

[14] *See also* Hill Reb., ComEd Ex. 19.0 Corr., 42:888-43:900 and Sch.15.

i. **Salaries and Wages**

Staff appears to find ComEd's analysis relating to salaries and wages to be the most controversial, but it should not be. Staff is correct that salaries and wages are affected by (1) number of employees and (2) salary and wage rates. Ms. Houtsma's testimony acknowledged from the outset, as Staff concedes, that ComEd's 2004 work force was one-third smaller than ComEd's 2000 work force. Houtsma Reh.Dir., ComEd Ex. 52.0 Corr., 4:80-82; Staff Reh.Br. at 29. An exhibit to Ms. Houtsma's testimony unequivocally showed that the test year amounts in the Uniform System of Accounts category for salaries and wages declined by $29.5 million from 2000 to 2004, and further that this lower amount was reflected in ComEd's requested A&G expense. ComEd Ex. 52.1. Ms. Houtsma also explained that the salaries and wages account was impacted by a number of factors between 2000 and 2004: it increased due to severance expense ($8.9 million) and higher wage rates ($9.1 million) and decreased due to the decline in the number of employees ($47.6 million). Houtsma Reh.Dir., ComEd Ex. 52.0 Corr., 9:152-10:180; ComEd Ex. 52.7; Houtsma Reh.Reb., ComEd Ex. 59.0, 8:169-9:175.

Finally, Ms. Houtsma explained that the decrease in salaries and wages due to the smaller work force was entirely offset by an increase in amounts paid to third parties (primarily Exelon Business Services Co. ("BSC")) for services previously performed by ComEd employees, amounts reflected in Account 923, Outside Services. Houtsma Reh.Reb., ComEd Ex. 59.0, 8:156-9:175. Thus, Accounts 920/921 and 923 considered collectively show an overall increase in those two components of A&G expense of slightly more than $56 million. ComEd Ex. 52.1. This increase is attributable to Exelon Way severance costs, salary and wage rate increases, governance costs, reclassification of IT depreciation and Sarbanes-Oxley costs. *Id.* Because the $47.5 million increase in Account 923 and the $47.6 million decrease in Account 920 - - both primarily attributable to the transfer of employees from ComEd to BSC - - offset each other, Ms. Houtsma did not explicitly identify costs for these services to be a driver for the increase in A&G expense. When viewed together, as they properly should be, they have no impact on overall A&G expense. ComEd Ex. 52.0 Corr., 15:273-19:350.

Staff ignores the comprehensiveness of Ms. Houtsma's salary and wage analysis, and mistakenly insists that Ms. Houtsma simply attempted to persuade the Commission that overall salaries and wages have been increasing and that ComEd was seeking a "$9.1 million upward adjustment of these costs." Staff Reh. Br. at 31. That is, respectfully, neither fair nor accurate, as the testimony, summarized above, shows.

In reality it is Staff that provides an improperly narrow analysis, consisting of only *two* of the fourteen A&G accounts - - Accounts 920 and 921 - - in an attempt to persuade the Commission that ComEd has overstated its A&G expenses by at least $79 million. Looking at only two of fourteen accounts can hardly be considered the "more complete view" that Staff claims to have provided. Staff Reh. Br. at 31. Using data that do not reflect the substantial adjustments made for ratemaking purposes and that are not applicable to the test years in this case, Staff concludes that salaries and wages have declined by $36 million and office supplies and expenses by $33 million, and therefore A&G expenses should have declined. Staff Reh. Br. at 30, 37. Using adjusted test year data, these two components of A&G expenses have decreased by $29.5 million (as shown on ComEd Ex. 52.1), not the $69 million by which Staff claims they have decreased.

Equally as important, Staff's analysis fails to acknowledge what happened with respect to other A&G accounts during the relevant period, most notably Outside Services, which <u>increased</u>

by $85.6 million. *See* ComEd Ex. 52.1.[15] This increase in the outside services costs is hardly surprising in view of Ms. Houtsma's testimony that the reduction in ComEd's workforce was accompanied by a transfer of ComEd employees to BSC (436 on January 1, 2004 alone) where they are conducting similar activities. This fact - - which Staff never acknowledges let alone counters - - explains the interrelationship between the decline in ComEd salaries and wages and the increase in outside services costs.

Inexplicably, Staff contends that Exhibit 52.1 does not provide the information the Commission had requested on rehearing, because the "$48 million adjustment" for Outside services, Account 923, was "not discussed" in Ms. Houtsma's testimony. Staff Reh. Br. at 41, quoting Mr. Lazare's cross-examination. This is again, and with respect, not true, as shown above. Ms. Houtsma's testimony specifically explained that this $48 (actually $47.5) million increase over which Mr. Lazare professed such confusion is largely attributable to the transfer of ComEd employees to BSC. Houtsma Reh.Reb., ComEd Ex. 59.0, 8:170-74. Moreover, if any doubt did exist, Ms. Houtsma was the very next witness following Mr. Lazare's cross-examination, but Staff made no effort on cross-examination to determine from Ms. Houtsma what those columns on her Exhibit meant, nor had Staff submitted a single data request with respect to ComEd's rehearing testimony on A&G expenses. Staff, of course, does not have any obligation to educate itself through cross-examination or otherwise, but it cannot claim that an unanswered question remains on the record and then simply refuse to develop that information. That would deprive the Commission of the record it deserves to create a meaningful basis for its decisions.

[15] ComEd's evidence shows that this Account increased because of changes in the corporate governance allocations ($22.3 million), IT depreciation ($8.1 million) and Sarbanes-Oxley costs ($7.8 million), as well as compensation for services performed by former ComEd employees now employed by BSC ($47.5 million). *See* ComEd. Ex. 52.1 and Houtsma Reh. Reb., ComEd Ex. 59.0, 8:174-9:175.

ii. Sarbanes-Oxley/Employee Health Care

Little needs to be added about the only other two components of A&G expenses Staff questions, Sarbanes-Oxley and employee health care. ComEd's Initial Brief on Rehearing has already shown why Staff's proposed adjustments in these areas are improper. But Staff's Rehearing Brief makes the further unfounded assertion that ComEd cited the Charles River and Towers Perrin studies to show the reasonableness of ComEd's Sarbanes-Oxley and employee health care expenditures, respectively. Staff Reh. Br. at 33-34. Nowhere in its rehearing testimony did ComEd assert, through any witness, that its costs should be considered reasonable because of anything in those studies, and nowhere did ComEd contend that the reasonableness of Sarbanes-Oxley costs should be judged based on their relationship to revenues. ComEd explained that Sarbanes-Oxley compliance is required by law, what the costs were spent on and why they were proper. Houtsma Reh.Dir., ComEd Ex. 52.0 Corr., 15:274-16:310; ComEd Ex. 52.9. Moreover, under the law, ComEd's expenditures are presumed to be prudent and reasonable and ComEd was not obligated to introduce any affirmative evidence of reasonableness in the absence of some specific testimony or other evidence that the costs in question were improperly or imprudently spent. *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n,* 327 Ill. App. 3d 768, 776 (3rd Dist. 2002); *City of Chicago v. People of Cook County*, 133 Ill. App. 3d 435, 442-43 (1st Dist. 1985).[16] Indeed the presumption of prudence is even stronger with respect to such costs as Sarbanes-Oxley, which are required by law. *Citizens Utility Board v. Ill. Commerce Comm'n*, 166 Ill. 2d 111 (1995). Here, no evidence of imprudence was ever offered with respect to either Sarbanes-Oxley or employee health care costs.

[16] The statement in the CCC Rehearing Brief that ComEd "operates from the false premise that, absent a finding of imprudence or unreasonableness, its stated costs should be presumed just and reasonable, whether supported by substantial evidence or not" (at 5) is legally wrong.

The Charles River and Towers Perrin studies were presented only as points of information for the Commission to assist its understanding generally of the magnitude of the costs resulting from the new Sarbanes-Oxley law and to understand better the forces driving health care costs. Accordingly, Mr. Lazare's assertion, cited in Staff's rehearing brief (at 34), that he is simply applying ComEd's "own test" of reasonableness is wide of the mark. ComEd demonstrated, in its initial rehearing brief, that the use of averages as Mr. Lazare did is unfair and improper ratemaking. In any event, when proper comparisons are made, ComEd is very close to average with respect to both health care and Sarbanes-Oxley costs.[17] *See* ComEd Reh.Br. at 40.

iii. Summary of A&G Expenses

At the end of the day, Staff's position, mainly that of Mr. Lazare, on rehearing with respect to A&G expenses is confusing, contradictory and almost entirely beside the point of the rehearing. The assertion that ComEd's A&G expenses have decreased since January 1, 2001 is based not on any "ratemaking" analysis but on raw unadjusted FERC Form 1 data that has little meaningful relationship (at least without further analysis, which Staff did not conduct) to what is filed as part of a rate case. Moreover, the assertion is incorrect when taken to 2004 (the test year in this case) as Staff itself admits when it acknowledges that A&G expenses increased between 2001 and 2004. Staff Reh. Br. at 39.

In any event, Staff goes on to say that it did not provide this A&G information "as a basis for the level of allowable A&G expense," but instead only to "illustrate the reasonableness of the Commission's conclusion that ComEd had not supported its requested increase in A&G costs since the last rate case." *Id*. But Staff's data have little if any bearing on what ComEd

[17] Furthermore, the notion that $6 million - -or more than 75% - - of Sarbanes-Oxley compliance costs should somehow be considered "supply-related" as Mr. Lazare implies simply because ComEd has over $4 billion in pass-through revenues is without any basis and defies common sense.

submitted; it is not meaningful to draw any conclusions about increases in A&G expenses between a 2000 test year and a 2004 test year, based on (A) a comparison of only two of fourteen accounts, or (B) the use of raw and unadjusted expense data comparing 2001 and 2005. Staff's position on A&G expenses on rehearing does not begin to answer the question posed by the Commission. ComEd should be allowed to recover an additional $62 million in A&G expenses because it has provided for the Commission the information it requested on rehearing.

b. <u>The Attorney General's Position on Severance Costs Should Be Rejected.</u>

The AG argues that $18.7 million of Exelon Way severance costs should be excluded from any recoverable A&G costs because they will be non-recurring. AG Reh.Br. at 7. This argument was correctly rejected by the Order (at 90) and the AG has introduced nothing new on rehearing on this point.[18] The Exelon Way severance cost recovery represents only a portion of the total severance costs incurred, reflecting an amortization of those costs over 7.5 years. *See* Hill Reb., ComEd Ex. 19.0 Rev., 46:972-49:1025 and Schedule 16. This is standard ratemaking treatment of a cost incurred in one or two years but expected to produce benefits and savings over a number of years. *Id.* The Commission should affirm its rejection of this argument.

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[18] The rehearing testimony of AG witness Effron argued that recovery of these severance costs should be disallowed because to allow them would give ComEd a "double recovery." ComEd has shown why this point is incorrect in its Initial Rehearing Brief. ComEd Reh.Br. at 42-43. The AG has not raised this point in its brief. In addition, the AG asserts that the Commission "excluded those severance expenses in its Final Order." AG Reh.Br. at 7. In fact, the Order expressly found that "ComEd's proposed severance costs related to the Exelon Way program are just and reasonable and therefore are approved." Order at 90. Despite this express approval of these costs, the improper inflation methodology adopted by the Order effectively denied ComEd recovery of these costs.

D. Rate of Return

1. Capital Structure

ComEd filed rates based on its repeatedly audited actual capital structure, consistent with its current delivery rates and with the treatment of the nuclear plant transfers twice accepted by the Commission in ComEd's last rate case.[19] Although the Order rejected that approach,[20] the Commission did not do so because it contained too much equity *per se*, nor did the Commission criticize ComEd's commitment to maintaining a financially sound capital structure with a sufficient equity cushion to withstand shocks. *See* Mitchell Reb., ComEd Ex. 20.0, 2:26-29, 3:49-9:192; Mitchell Sur., ComEd Ex. 37.0, 8:157-75; Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 28:596-99. Indeed, the Order expressly recognized the "duty of the Commission to protect both ratepayers and investors" and found that simply removing $2.634 billion of equity did not leave ComEd with a reasonable capital structure. Order at 130. The Commission, instead, found that the reasonable approach was to impute a capital structure of 42.86% equity and 57.14% debt. *Id*. Such an imputed capital structure represents the Commission's view of a capital structure that reasonable utility management would maintain. The record, including a review of past Commission decisions, shows that "the most significant factor to consider when adopting an imputed capital structure is whether the proposed common equity ratio is reasonable when

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[19] *Commonwealth Edison Co.*, Docket 01-0423 (Interim Order, Apr. 1, 2002) at 112; *Commonwealth Edison Co.*, Docket 01-0423 (Final Order, Mar. 28, 2003) at 129-30. In neither order was there any reduction made to ComEd's book equity on account of the nuclear plant transfers or their accounting that was reviewed and approved by the Commission in *Commonwealth Edison Co.*, Docket Nos. 00-0369 and 00-0394 (cons) (Order, August 17, 2000) at 27.

[20] The Order rejected this approach not because a capital structure with 54.2% equity was inherently unreasonable, but because the Commission found that ComEd's actual capital structure included goodwill arising from the transfer of ComEd's former nuclear plants and that goodwill should not be considered in ratemaking. ComEd believes that this conclusion was legally erroneous and contrary to the evidence and appropriately preserved its arguments. However, on rehearing ComEd did not just reargue that position, but instead provided the Commission with additional evidence including with respect to possible imputed capital structures.

measured against the capital structures of comparable utilities." Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 11:222-25.[21]

However, instead of presenting evidence concerning an appropriate imputed capital structure for ComEd, some parties continue to argue for the same unrealistic and highly-leveraged 37.11% capital structure that the Commission has already rejected. That capital structure lies far outside of the mainstream of capital structures approved by this Commission, is significantly more leveraged than the capital structures of the comparable sample group utilities, and includes an equity cushion below that which the uncontradicted testimony shows is appropriate. Indeed, because of the effect of other disallowances in the Order and changes in both the capital market and ComEd's financial condition, the evidence submitted on rehearing makes an even weaker case for the 37.11% equity capital structure than that which the Commission already rejected. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 12:252 – 14:295.

In contrast, the evidence submitted by ComEd on rehearing details the support for an imputed capital structure with 46% equity (as originally proposed by the ALJs) and the evidence submitted on rehearing supporting a capital structure with 42.86% equity. ComEd Reh.Br. at 44-47. If the Commission continues to reject ComEd's actual capital structure, the Commission should approve an imputed capital structure with, at a minimum, 42.86% equity.

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[21] Examples include *Sundale Utilities, Inc.,* Docket No. 04-0637 (Order, Aug. 9, 2005) (approving an imputed capital structure after noting that Staff had compared the proposed capital structure to the average capital structure ratios of other companies, finding it to be "very close" and therefore "reasonable for ratemaking purposes"); *Consumers Gas Co.,* Docket No. 92-0283 (Order, April 21, 1993) (approving an imputed capital structure based on Staff's analysis of the common equity ratios for the industry using Value Line and S&P data); *Illinois Commerce Comm'n v. Eldorado Water Co.,* Docket No. 93-0219 (Cons.) (Order, July 7, 1994) (approving Staff's imputed capital structure consisting of 60% common equity and 40% long-term debt, concluding that it was closer to the "industry's average capital structure"); *GTE North Inc.,* ICC Docket No. 93-0301 (Cons.) (Order, Oct. 11, 1994) (approving a utility's capital structure, noting that Staff had compared the common equity ratio with both the current and forecasted values in the industry, finding the proposed ratio to be "reasonably close to the average"); *Central Illinois Public Service Co., et al.*, Docket No. 00-0802 (Order, Dec. 11, 2001) (approving a compromise proposal for a utility's weighted average cost of capital after noting that both Staff and IIEC supported an imputed capital structure with a level of common equity "that Staff believed to be consistent with comparable companies").

a. The Commission Should Continue To Reject The Unrealistic 37.11% Equity Capital Structure

The attacks on the Order fall into two categories: claims that no evidence shows that the 37.11% capital structure is unreasonable and claims that any other capital structure is impermissible. Both are wrong.

First, ample evidence demonstrates that the 37.11% equity capital structure proposed by AG, CCC, and Staff[22] is unreasonable. Its advocates ignore: (1) the best objective evidence of what is a just and reasonable imputed capital structure, (2) the Standard & Poor's ("S&P") equity-debt ratio guideline applicable to utility credit ratings, (3) the fact that a 37.11% equity capital structure is inconsistent with prudent and beneficial utility management; and (4) the fact that the 37.11% equity capital structure would significantly impair ComEd's financial condition at a time when, by most measures, it is already at the lowest investment grade rating. The record shows:

1. Evidence of reasonableness based on comparable company capital structures. "[T]he best measure of how reasonable management would have behaved in developing an imputed capital structure is to look to how their peers at other utilities have behaved, considering all the concerns that utility management must face – including maintaining a capital structure that can withstand shocks – rather than working backwards from a subset of credit metrics." Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 12:247-51. 37.11% is a much thinner equity ratio than those of the financially-sound utilities chosen by the experts in this case as comparable to ComEd. 37.11% is a lower equity ratio than that of *any* utility in Staff's sample of comparable companies. Mitchell Sur., ComEd Ex. 37.0 2nd Corr., 18:367–19:390. "Staff's comparable

ComEd, recognizing that there is evidence in the record to support it. IIEC's alternative arguments are also [22] IIEC and DOE support the capital structure adopted by the Commission as part of their omnibus stipulation with addressed herein.

group had an average common equity ratio of 48.8%. ComEd's comparable gas company sample had an average equity ratio of 51.8%. ComEd's electric company sample had a common equity ratio of 45.7%. In addition, a broader sample of electric utilities generally prepared by AUS consulting had a common equity ratio of 48%." Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 26:551-55; *see also* ComEd Exs. 21.2, 21.5. Although Staff criticizes the calculation of some of these averages, even Staff's calculation of the average equity ratio is over 45%. *See* Staff Br. at 49. Moreover, even the carefully-chosen "sample" of utilities cited by CCC witness Bodmer fails to support a highly leveraged capital structure. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 26:556-568; Mitchell Sur., ComEd Ex. 37.0 2nd Corr., 9:187 – 11:222. In short, none of the evidence of comparable capital structures can come close to justifying the reasonableness of a 37.11% equity ratio.

2. Evidence of failure to meet debt ratio guidelines. A capital structure with 37.11% equity falls well outside the S&P guidelines for the common equity ratio of an A-rated electric utility with even the "4" business profile score that ComEd had before the recent downgrades. Mitchell Reb., ComEd Ex. 20.0, 4:65-67. Indeed, a 37.11% equity ratio falls below the S&P debt ratio guidelines for even a BBB company. Janous Dir., IIEC Ex. 4.0, 8:112 (ratios for BBB companies with a business profile score of "4" fall in the range of 52%-62% debt, with a corresponding 48-38% equity); *see* Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 13:270-76. Staff and CCC emphasize only the cash flow guidelines, ignoring that a utility must also have sufficient equity to withstand inevitable fluctuations in cash flows and other shocks that occur in any business. No matter how robust cash flow is at any point in time, having a strong capital structure is what provides resilience. The proposed 37.11% capital structure does not correspond with a financially strong utility.

3. Reasonable utility management would not result in a capital structure with 37.11% equity. ComEd maintained a balanced capital structure for good business reasons that benefited the public. The record shows that ComEd has consistently acted to keep its common equity balance at or above $5 billion and, since 2001, has taken decisive actions to reduce its debt. Mitchell Reb., ComEd Ex. 20.0, 7:141-50; *see also* Mitchell Sur., ComEd Ex. 37.0 2nd Corr., 17:340 (chart showing consistent maintenance of equity balances). The evidence shows that those actions were beneficial. Mitchell Dir., ComEd Ex. 7.0, 7:144 - 8:156. No witness denied those benefits or testified that ComEd's actions were in any way imprudent or unreasonable. The proposed 37.11% equity capital structure, by contrast, ignores the reasons for maintaining a balanced capital structure and is inconsistent with prudent actions of management.

4. Commission decisions approving reasonable capital structures for other delivery utilities. The Commission's own past actions recognize the reasonableness of delivery services utilities maintaining capital structures with equity ratios in the mid-40's and above. IIEC witness Gorman advocated strongly for an imputed 50% equity capital structure, observing correctly that equity percentages in the 50% range both comport with past Commission Orders and can be reconciled with the leverage ratios of ComEd's peers. Gorman Dir., IIEC Ex. 3.0 Corr., 16:363-72.[23] Indeed, recent Commission examples have been higher and include a common equity ratio for Nicor Gas Company of 56.37%, for AmerenIP of 53.09%, for South Beloit Water Gas & Electric of 53%, and for AmerenUE of 52.7%.[24] The fact that these are actual capital structures is no reason to discount them. The Commission, in adopting an imputed capital structure, should

[23] In his rebuttal testimony, Mr. Gorman also supported the 37/63 capital structure based on his view at that time of the "goodwill" argument below, but Mr. Gorman did not disavow his earlier testimony about the reasonableness of a capital structure with up to 50% equity. Moreover, IIEC now stipulates that substantial evidence supports the Order's 42.86% equity capital structure.

[24] Docket No. 04-0779 (Order September 2005); Docket No. 04-0476 (Order May 17, 2005); Docket No. 03-0676 (Order October 6, 2004); and Docket No. 03-0009 (Order October 22, 2003).

strive to adopt a capital structure that is reasonable when measured against actual peer utilities and past Commission orders, not to create an outlier.

The keystone of the argument for the reasonableness of the 37.11% equity capital structure is that its unprecedented leverage nonetheless meets two of the three S&P guidelines for credit ratings – those dealing with cash flow at a particular point in time – while ignoring the more directly-applicable equity-debt ratio guideline. Mitchell Reb., ComEd Ex. 20.0, 4:83-5:97, 9:176-82; Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 12:252-13:276; s*ee*, *e.g.*, McNally Reh., Staff Ex. 26.0, 5:94-110, and Sched. 26.3 Nothing permits simply ignoring the equity-debt ratio guideline. Indeed, Staff and the Commission have both historically recognized the importance of maintaining an adequate equity ratio and have used this criterion in evaluating capital structures. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 11:222 - 12:251, and cases cited therein. IIEC witness Janous also recognized the independent importance of maintaining a strong equity ratio, and emphasized that the "debt ratio (total debt/total capital)" is central to how "financial risk is quantified …" IIEC Ex. 4.0, 7:99-100. Indeed, the debt ratio guidelines are the only S&P guidelines he includes in his testimony. *Id.* at 8:113-18.

Moreover, Staff's lengthy argument concerning cash-flow, or "FFO," calculations suffers from two additional flaws. First, Staff fails to explain why the Commission should change its decision concerning the unreasonableness of the 37.11% equity capital structure when the evidence on rehearing shows that the FFO metrics are <u>less</u> <u>favorable</u> to Staff's position than prior to rehearing. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 14:288-95. Staff failed, for example, to consider the Commission's other disallowances in its calculations. *Id.,* 15:320-27. As ComEd pointed out in its initial brief on rehearing, Staff's rehearing testimony shows that a 37.11% common equity capital structure would result in a <u>weaker</u> ComEd than was indicated by Staff's prior testimony, even when only the FFO metrics are considered. ComEd Reh.Br. at 48; Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 12:252 – 14:295. Staff's analysis of credit standards also fails to reflect the fact that S&P has downgraded ComEd and assigned it a higher risk business profile of "8". Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 15:328 – 17:351. A BBB-range utility with a business profile "8" is expected to maintain a common equity ratio of 48 to 58% -- far higher than Staff's recommended equity ratio of 37.11%.[25]

CCC's claims concerning ComEd's dramatic ratings downgrades are likewise incorrect. As Mr. Mitchell's uncontradicted rehearing testimony pointed out, ComEd has recently been downgraded by the rating agencies. By most measures it is now a single notch above non-investment grade, also known as "junk," status. Those downgrades are not the basis of ComEd's request for rate relief; its proposed rates are needed to recover its costs. Moreover, while the recovery of its supply costs is clearly a major concern to rating agencies, adverse regulatory actions generally, including the prospect of ComEd's rates not recovering its delivery costs, influenced the ratings agencies. Indeed, immediately following entry of the Order, Fitch Ratings downgraded ComEd, noting that "the lower ratings reflect the unfavorable rate order" entered by the ICC and generally increased business risk from ongoing regulatory uncertainty in Illinois. Mitchell Reh.Dir., ComEd Ex. 51.0, 3:52 – 4:67; ComEd Ex. 51.2. But, even more importantly, prospectively, rating agencies review the "capital structure employed to arrive at the rate of return" in rate cases, and that, in S&P's own words, regulation is "the most important factor

[25] Staff suggests that the Commission ignore ComEd's current credit rating of BBB-, discussed in the next paragraph, and its business profile of "8", calling them "not relevant" and claiming that, if the rate freeze legislation fails, customers will be "unfairly charged for risks that did not materialize." Staff Reh.Br. at 53. Staff's premise is false -- those risks have already materialized, and have lowered ComEd's credit ratings accordingly. What Staff is really asking the Commission to do is to ignore those risks, and "assume that utility rates will remain subject to the decisions of the Commission and auction power prices" (*id.* at 54), despite the fact that regulatory risk has already increased ComEd's business risk and financing costs. Staff argues that "no one can accurately predict the future" (*id.*), yet it invites the Commission to do just that – predict that rate freeze legislation will fail, that ComEd will be allowed to recover fully its costs, and that ComEd's credit ratings will improve before the rates become effective. The Commission should not make these assumptions.

affecting T&D companies' credit quality because it provides the means by which a utility can realize predictable and stable financial results." Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 19:399-404; Gorman Dir., IIEC Ex. 3.0, at WP 1 of 10, *Keys to Success for US Electricity Transmission and Distribution Companies*, at 3 of 9. Against this background, it is simply not credible to claim that ComEd could readily maintain its financial strength, let alone improve to an A- credit rating, were the Commission to further reduce its approved equity ratio.

Staff's FFO calculations are also based on the faulty premise that ComEd's funds from operations will recover all of the expenses included in the calculation. This calculation ignores the sizable disallowances otherwise made by the Order and the fact that those disallowances will, in turn, reduce ComEd's available cash. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 14:296 – 15:327.

Second, the parties supporting the 37.11% equity capital structure offer three closely related arguments which they say require the Commission to reverse its Order in favor of their proposed capital structure without regard to the reasonableness of its equity ratio. The first of these is the AG's and CCC's claim that the Commission has no alternative but to adopt a capital structure with only 37.11% equity, because anything less would leave goodwill in the capital structure. This argument is simplistic and wrong.

Fundamentally, an imputed capital structure is not an adjusted actual capital structure. The imputed capital structure adopted by the Commission is not derived from any adjustment to ComEd's actual capital structure, nor does it include any component of the actual capital structure, goodwill or otherwise. Rather, when the Commission adopts an imputed capital structure, it determines that it is just and reasonable to disregard the actual capitalization of the utility and instead set the debt and equity ratios for ratemaking purposes based on what capital structure a reasonable, comparable utility would have maintained. *See, e.g. Sundale Utilities, Inc.*, Docket No. 04-0637 (Order, Aug. 9, 2005); *Consumers Gas Co.*, Docket No. 92-0283 (Order, April 21, 1993); *Illinois Commerce Comm'n v. Eldorado Water Co.*, ICC Docket No. 93-0219 (Cons.) (Order, July 7, 1994) ; *GTE North Inc.*, Docket No. 93-0301 (Cons.) (Order, Oct. 11, 1994); *Central Illinois Public Service Co., et al.*, Docket No. 00-0802 (Order, Dec. 11, 2001). As Mr. Mitchell testified (Reh.Reb., ComEd Ex. 58.0 Corr., 22:475 – 23:480):

> An imputed capital structure, by definition, is a capital structure the Commission concludes is just and reasonable and should be approved notwithstanding ComEd's actual capital structure. An imputed capital structure does not include goodwill. It is approved because it reflects a reasonable balance of equity and debt when compared to peer groups, industry standards and benchmarks. Because, by its nature, it includes no goodwill, there is nothing to remove.

Indeed, if the rule were otherwise, all imputed capital structures would be subject to attack by any interested party on the grounds that it did not reflect their own favored adjustment.

In addition, this argument falsely assumes that if ComEd were to have removed an additional $2.634 billion from its capital structure on account of the nuclear unit transfer, that all of that reduction would come from equity. As the Order recognized, the nuclear transfer could have been structured in a number of ways. Order at 129. The record is also clear that both equity and debt supported the construction of those assets in the first place. Houtsma Sur., ComEd Ex. 35.0, 17:374-18:391; Houtsma Tr. at 1836:9-16. No witness disagreed. That is all the more reason why, if the Commission determines to further reduce ComEd's total capitalization as a result of the nuclear unit transfer it should nonetheless set ComEd's equity ratio for ratemaking purposes using a reasonable imputed capital structure and not arbitrarily reduce only equity.

The AG, CCC, and (in the alternative) IIEC also argue that ComEd's equity must be set to 37.11% because otherwise ComEd will supposedly be earning a return on non-delivery assets.

This argument is equally flawed. ComEd earns a return only on its rate base, not its capitalization. ComEd's rate base contains, as the Order found, only delivery assets. Order at 54. The aggregate size of ComEd's capitalization does not affect its rates. Moreover, ComEd's total capital – whatever it may be – finances ComEd's operations and ComEd's <u>only</u> operations are delivery. Crumrine Dir., ComEd Ex. 9.0 Corr., 32:716-21. ComEd has no generation assets to support and no part of ComEd's total capitalization, be it debt or equity, supports generation.[26]

The argument that there "must be" some capital supporting a non-delivery activity because ComEd's total capitalization exceeds its rate base also lacks merit. The notion that rate base and total capital must be even approximately equal finds no support in logic or the law. They are entirely separate concepts. They can and do significantly diverge for utilities for entirely appropriate reasons having nothing at all to do with plant write-downs, plant transfers, or goodwill[27] and even Staff's capital structure witness acknowledges that there is nothing wrong with a capital structure and rate base differing in amount. Kight, Tr. At 1842:20 – 1844:6. ComEd's rate base is based on net plant values, while total capitalization is based on current market conditions and financial decisions (*e.g.*, when and whether to refinance debt) that have nothing to do with rate base. Moreover, the <u>size</u> of the rate base affects rates. By contrast, the size of a utility's total capitalization is irrelevant to its rates – utilities do not earn a return on their capital, only on their net rate base. Only the ratio between the components of the capital structure affect rates.

[26] Even were the Commission to determine that ComEd has a supply procurement function that uses a material portion of ComEd's assets, those assets are undeniably used and useful. ComEd is required to procure supply for retail customers and is entitled through its retail rates to a return of and on the investment in the assets used to procure that supply. Regardless, no part of ComEd's capitalization supports assets not serving its retail customers.

[27] For example, they will diverge any time the utility's depreciation rate on an investment (which will drive down rate base) differs from the rate at which it retires whatever debt component may have been used to finance the investment. Kight, Tr. 1843:13-17.

In any event, no "goodwill asset" was in <u>rate</u> <u>base</u> in ComEd's original proposal, and certainly none is in the rate base approved by the Order. And, even if a deduction were required from ComEd's total capital to remove goodwill, no reason supports making that deduction only from equity, thereby skewing the equity ratio. As noted above, the nuclear assets were supported by both debt and equity. *See* Houtsma Sur., ComEd Ex. 35.0, 17: 374 – 18:391.

Finally, CCC and (in the alternative) IIEC argue that Section 9-230 and the prohibition on earning on non-delivery plant compel adoption of the 37.11% capital structure. This argument also confuses capitalization and rate base. ComEd's rate base is fully devoted to delivery and customer service functions and it is entirely appropriate for ComEd to recover a return of and on that investment. As for the rate of return, it also was not increased by the Order as a result of any affiliation with an unregulated entity, or any affiliate risk. The essence of the Commission's determination in the Order that the imputed capital was reasonable is its finding that a 42.86% equity ratio is a reasonable equity ratio for a pure delivery utility. That imputed capital structure is no more or less leveraged than if ComEd had never owned nuclear plants.

b. Imputed Capital Structures With 46% Or 42.86% Equity Are Supported By Evidence

ComEd identified specific record support for an imputed capital structure with 46% equity. Mitchell Reh.Dir., ComEd Ex. 51.0, 16:340 – 17:362; Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 27:575-83. As ComEd noted in its initial brief on rehearing, that evidence includes: (1) the capital structures of peer group utilities, (2) Staff witness Kight's identification of financially sound utilities with business profiles of "4" (including Old Dominion), which have an average common equity ratio closely approximating 46%; and (3) the 43% midpoint of S&P's benchmark range of common equity ratios for the lowest investment grade ("BBB") utilities with business profiles of "4". ComEd Reh.Br. at 47. CCC's claim (CCC Reh.Br. at 20) that no evidence supports this capital structure is simply wrong.

Likewise, evidence in the record on rehearing supports an imputed capital structure with 42.86% common equity. That evidence includes: (1) Mr. McNally's testimony recognizing the "nexus" between ComEd's ability to maintain financial strength in the period after the Commission adopted a 42.86% equity capital structure in Docket 01-0423 and the issue of what capital structure to impute in this case, and (2) Mr. Bodmer's testimony that ComEd's equity ratio as of June 30, 2006 would be nearly 42% even if all goodwill were eliminated in the manner advocated by Staff, CCC and IIEC, *i.e.*, through a reduction only in equity, and would be above 43% if a *pro forma* adjustment for just one additional year of TFI repayments were made. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 27:590 – 29:620.

Staff's principal criticism of the Order appears to be Staff's view that it does not contain sufficient detail. *See* Staff Reh. Br. at 43. Given the evidence that a 37.11% equity ratio is not consistent with either comparable utilities' capital structures or with ComEd's maintenance of financial strength, this concern is readily addressed. *See* ComEd Proposed Order on Rehearing at 32-33. Moreover, Staff's claim that Mr. Mitchell's testimony does not support the Order's imputed capital structure (Staff Br. at 45-46) misses the mark. Mr. Mitchell, first, points out that Staff's own testimony supports the nexus between the reasonability of the capital structure in Docket 01-0423 and an imputed capital structure in this docket. Moreover, the fact that ComEd chose a June 30, 2005, capital structure measurement period does not prevent the Commission from considering evidence of how a proposed capital structure – especially an imputed capital structure applicable to future rates – fares under newer data. ComEd indeed did propose an actual capital structure, measured as of June, 2005, with 54.2% equity. But, if that capital structure is to be replaced by an imputed capital structure not of ComEd's proposing, it is certainly wrong for Staff to call that capital structure "unsupported" when in fact it is supported by even newer evidence.

2. <u>Cost of Common Equity</u>

The Order approves a cost of common equity ("COE") of 10.045%, which ComEd, IIEC, and DOE have stipulated is supported by substantial evidence. ComEd Reh. Br. at 50; IIEC Reh. Br. at 3; DOE Reh. Br. at 3. The Commission should concur with this stipulation. If it does not, however, the Commission should approve a higher COE, as substantial evidence also supports both ComEd's proposed 11.00% cost of equity and Staff's proposed 10.19% return on equity.

Staff continues to advocate its proposed 10.19% return on equity. Staff Reh. Br. at 56. Staff claims, however, that if the capital structure adopted by the Commission has an equity component greater than Staff's proposed 37.11%, then Staff's proposed return on equity should be adjusted downward. Staff Reh. Br. at 56. Staff bases this contention on its assertions that its proposal reflects the BBB+/A- average credit rating of the companies in its comparable sample group, and that ComEd would have an even higher credit rating if its equity ratio were set above 37.11%. Staff Reh. Br. at 56. The record does not support these assertions.

If ComEd were allowed only a 37.11% equity component, its credit rating would not even be close to BBB+/A-; indeed, it would barely reach investment grade. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 16:339-46. In contrast, the sample companies cited by Staff – with their BBB+/A- average credit rating – have much higher equity components, averaging 48.8% for 2004, and projected to average 52.0% for 2008-2010. Hadaway Reb., ComEd Ex. 21.0, 6:136 - 7:141, ComEd Ex. 21.2. The same is true for the comparable company sample proposed by ComEd, which averaged 45.7% (electric) and 51.8% (gas) for 2004, and are projected to average 48.6% (electric) and 54.4% (gas) for 2008-2010. Hadaway Reb., ComEd Ex. 21.0, 15:347-

16:358, ComEd Ex. 21.5. Moreover, as discussed above, Staff's additional assertion that the capital structures adopted by both the ALJs' Proposed Order and the Commission's Order support an A credit rating (Staff Reh.Br. at 56) is unfounded. Among other things, once the disallowances in those Orders are taken into account, ComEd's credit rating is well below that mark. E.g., Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 24:518-25:530.

Staff also contends that ComEd's proposed 11.00% COE was properly omitted from the averaging of proposed COEs in the Order. Staff Reh.Br. at 57. The record shows, however, that ComEd's proposal stemmed from a mainstream, rational methodology very similar to the one used by Staff. *See* Mitchell Reh.Dir., ComEd Ex. 51.0, 19:394-98. Both ComEd and Staff used traditional discounted cash flow models and the most recent and accurate securities pricing data. Mitchell Reh.Dir., ComEd Ex. 51.0, 19:395-96. In addition, their samples were similar in terms of risk. McNally Dir., Staff Ex. 5.0, 24:468-69. While a difference remained concerning the means of estimating long-term growth rates, both ComEd's and Staff's methodologies were sound and capable of supporting a reasonable estimate.[28]

Despite these similarities, the Order appears to reduce artificially the allowed COE by averaging Staff's calculation of a 10.19% cost of equity with IIEC's methodologically flawed 9.9% estimated cost of equity. Order at 155. The record shows that IIEC's methodology used neither the most accurate growth rate data nor long-term growth rate data appropriate for its own long-term constant growth model. Mitchell Reh.Dir., ComEd Ex. 51.0, 19:401-02. Moreover, two of IIEC's three methodologies (risk premium and CAPM) produced estimates of the cost of

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[28] In fact, Staff witness McNally stated that the difference in Staff's and ComEd's COE proposals was "due almost entirely" to growth rates. *E.g.*, McNally Dir., Staff Ex. 5.0, 18:350-19:354, 24:469-72, 28:552-54. When Mr. McNally used his own methodology on ComEd witness Hadaway's sample data, he came up with average COEs of 10.09% (gas) and 10.21% (electric), which together average within only four basis points of Staff's own recommendation. McNally Dir., Staff Ex. 5.0, 23:457-24:463.

equity of 10.2%, above that recommended by Staff. Mitchell Reh.Dir., ComEd Ex. 51.0, 19:403-04. Given this evidence, reducing ComEd's allowed cost of equity below that supported by Staff's analysis by simply averaging in IIEC's downwardly biased recommendation does not result in a more reliable value. Rather, it simply gives credence to a methodology (IIEC's) that the evidence showed to be flawed and inferior to either Staff's or ComEd's analyses.

At a minimum, then, the Order should be changed either to reflect Staff's 10.19% COE alone or, if the Commission continues to average other calculations with Staff's, to include not only IIEC's, but also ComEd's. Averaging ComEd's 11.0% calculation with the Staff and IIEC estimates would result in a 10.36% cost of equity. Mitchell Reh.Dir., ComEd Ex. 51.0, 20:428-29.[29]

IIEC contends that even if the methodologies used by Staff and ComEd were similar, ComEd's growth rate and its resultant COE proposal were still not reasonable. IIEC Reh.Br. at 11-12. Yet substantial evidence demonstrates that ComEd's growth rate was in fact reasonable. *See* Hadaway Sur., ComEd Ex. 38.0, 5:112-17, 17:397-18:405; *see also* ComEd Rep.Br. at 104-06; ComEd Init.Br. at 178-79. The record shows that the resultant 11.0% cost of equity reflects the actual cost of raising equity capital and is reasonable when compared to the costs of comparable companies and to the results of recent cost of equity determinations in Illinois and other jurisdictions. Mitchell Reh.Dir., ComEd Ex. 51.0, 19:413-15. For example, the average cost of equity allowed by regulatory commissions in the fourth quarter of 2005 was 10.75%. Hadaway Reb., ComEd Ex. 21.0, 2:26-27. At the same time, the evidence indicates that Staff's

[29] There is no merit in IIEC's argument that if the Commission uses ComEd's estimate in its average, it must use all estimates, "regardless of [their] acceptability under the law," IIEC Reh.Br. at 12. Logically, if the Commission is creating a reasonable average, it should use the reasonable estimates available. Here, the only other party proposing a COE was CCC. CCC used a fundamentally deficient methodology that does not measure the investors required returns and that has never been accepted by the Commission or other state regulatory body. That methodology produced a deviant 7.75% COE. This is a far cry from the ComEd-Staff dispute over what growth rate to use in the accepted model. Thus, excluding CCC's proposal from the average makes sense; not including ComEd's reasonable, mainstream COE, however, does not.

proposal of 10.19% and IIEC's proposal of 9.9% constituted a "departure from the trend of rising capital costs" and are "below the mainstream" of costs of equity in the United States. Hadaway Reb., ComEd Ex. 21.0, 1:21 – 2:30; ComEd Ex. 38.1.

IIEC claims that by citing other COEs, ComEd is, in effect, asking the Commission to base its COE on prior actions of other commissions. IIEC Reh.Br. at 13. They are wrong. ComEd is not asking that other utilities' COEs should set ComEd's COE, or seeking to substitute other commissions' judgments for this Commission's. But, because ComEd and other utilities compete for the same capital in the same capital markets, other utilities' COEs serve as a benchmark for determining what management needs to pay investors to raise capital. It is important that ComEd's allowed return on equity be comparable to its peers' returns because ComEd competes with those companies for capital. Bodmer, Tr. 1229:15-22. If such competitors pay more to investors, ComEd will be at a disadvantage.

CCC continues to push its highly unrealistic proposal of a 7.75% COE. CCC Reh. Br. at 20-22. There is no basis for this proposal, and the Order correctly rejected it. Order at 154. The record shows that CCC's argument is based on flawed premises and conclusions about investment bank opinions in the context of holding company mergers, which do not estimate the equity returns required in utility rate cases. Mitchell Reh.Dir., ComEd Ex. 51.0, 21:435-38. The evidence also demonstrates that such an approach has never been accepted by regulators as a means to establish utility equity costs for ratemaking purposes. Mitchell Reh.Dir., ComEd Ex. 51.0, 21:438-39. As the Order found, "the problems inherent with the use of the investment bank analyses outweigh their contribution to the entire body of evidence …." Order at 154. Additionally, the record shows that CCC relies on incorrect assumptions about the meaning and use of market-to-book ratios, and confuses ComEd with Exelon in its analysis. Mitchell Reh.Dir., ComEd Ex. 51.0, 21:441-43.

CCC claims that the Order does not indicate whether the Commission considered Mr. Bodmer's discounted cash flow and CAPM analyses. CCC Reh.Br. at 21. As CCC noted, however, those analyses were intended to "confirm" the highly flawed "investment bank analysis" result. CCC Reh.Br. at 21. The Order quite obviously considered Mr. Bodmer's flawed analyses, noting, "CCC claims that each of these results [CAPM analysis, DCF analysis and price to earnings ratio analysis] confirm that Mr. Bodmer's investment bank analysis produces a reasonable cost of equity" (Order at 145), which the Order then properly rejected. Order at 153-55. Given the rank unreasonableness of that result – among other things, being more than 200 basis points below the lowest proposal of any other party – whether other approaches reached similarly unreasonable conclusions is of no import.

CCC's position is not rendered any less unreasonable by the Lehman Brothers letter (ComEd Cross Ex. 6) to which it refers. CCC claims that that letter, which included a statement that returns on equity "are typically 300 or more basis points more than the discount rates used in investment bank fairness opinions," somehow confirms Mr. Bodmer's proposed COE of 7.75%, as ComEd requested 11% and 11% minus 3% yields 8%. CCC Reh. Br. at 21-22. Yet this statement in no way changes the impropriety of using an investment bank analysis. It remains wholly unsuitable as a technique to set the required rate of return on equity for a utility, and CCC offers nothing new in this regard. The Commission has already considered and rejected CCC's argument on this score. Order at 146, 153-55. Additionally, contrary to CCC's allegation, the letter bolsters ComEd's position: if the investment bank discount rate is 7.75% (as CCC posits), and, pursuant to the letter, returns on equity are typically 300 or more basis point higher, then the cost of equity is at least 10.75%, which is quite close to ComEd's proposed 11%.

3. <u>Cost of Long-Term Debt</u>

The Order properly concluded that ComEd's embedded cost of long-term debt was 6.48%. No party takes issue on rehearing with this determination. Staff, in fact, explicitly recognizes its propriety. Staff Reh.Br. at 55. That determination is based on what interest and other costs ComEd actually agreed to pay at the time the debt was issued.

Nonetheless, Staff claims that the embedded cost of ComEd's debt should be reduced if the Commission does not adopt Staff's capital structure. Staff asserts that "many of ComEd's long-term debt series carry the higher interest rate associated with the lower credit rating ComEd had at the time of their issuances," and that the cost of such series should be adjusted to reflect interest rates that supposedly would have been available had ComEd had an A- rating. Staff Reh.Br. at 55. Nothing supports this position.

As the record makes clear, neither Staff nor any other party has demonstrated any error in the calculation of the actual cost of ComEd's debt approved by the Order. The cost of existing, embedded debt does not change when ComEd's credit ratings change. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 31:653. ComEd pays holders of its bonds based on interest rates set when the debt was issued. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 31:661. The fact that ComEd's credit metrics and credit ratings changed thereafter – or are assumed to change under an imputed capital structure – does not affect the cost of that debt. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 31:664-65. Thus, Staff's invocation of the "financial tenet that lower risk reduces costs" (Staff Reh. Br. at 55) is irrelevant here. The embedded cost of ComEd's long-term debt is fixed and is the appropriate cost of debt to use in this case. Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 31:666.

Staff fares no better with its contention it is somehow "unfair" to use an equity ratio in an imputed capital structure while also using ComEd's actual cost of long-term debt. Staff Reh.Br. at 55. As noted above, an imputed capital structure, with an equity component of either 42.86% or 46%, is supported by the record. Regardless of which ratio is used, however, the cost of ComEd's long-term debt does not change. Indeed, what actually would be "unfair" would be to ignore that actual, fixed cost.

In addition, even if Staff's position were correct, its own evidence demonstrates that no adjustment would be necessary. Staff Ex. 26.1 (at 3-4) shows that more than 75% of the First Mortgage Bonds ("FMBs") used in computing ComEd's 6.48% embedded cost of debt were issued at a rating of A- (prior to August 1992 and between October 2000 and June 2005). Thus, the majority of the senior secured/FMBs at that time were already at the A- level.[30] Mitchell Reh.Reb., ComEd Ex. 58.0 Corr., 32:684-89.

E. RATE DESIGN

1. Rider GCB and Rider GCB 7

a. Statutory Construction

For the reasons stated in ComEd's, Staff's and IIEC's Initial Briefs, nothing in the language of Section 16-125A justifies retaining Rider GCB. The arguments advanced to the contrary, most particularly by the City of Chicago, Cook County State's Attorney's Office and the Board of Education of the City of Chicago ("CCB"), lack merit.

CCB make three arguments in favor of a rate freeze. They argue, first, that the plain language of the statute mandates a rate freeze; second, that the canon of statutory construction that specific provisions control over general, leads to the same result; and, third, that interpreting

[30] Staff's suggestion that the capital structures in the Proposed Order and the Final Order both indicate an A credit rating (Staff Reh. Br. at 55 n.12) is incorrect for the reasons noted above.

Section 16-125A in such a way as to abolish Rider GCB would make some of the statutory language superfluous. Each of these arguments is wrong.

First, nothing in the plain meaning of Section 16-125A(b) speaks to a rate freeze:

> "In implementing the provisions of this Section, the rates and charges applicable under the combined billing tariff of the serving utility in effect on May 1, 1997 shall apply to all load of eligible government customers selected by the governmental customers including, but not limited to, load served under contract." (emphasis added)

At the outset, Section 16-125A is divided into two subsections, (a) and (b). Subsection (a) contains the consolidated billing provision. Subsection (b) speaks of the means of "implementing" the Section, *i.e.*, how the consolidated billing provision in (a) is to be implemented. It is plain, in other words, that Section 16-125(A)(b) – the section upon which CCB rely – is subordinate to, and only explanatory of, the principal substantive provision in Section 16-125(A), subsection (a). Properly understood, subsection (b) has a very limited and narrow purpose, to explain how subsection (a) is to be implemented, not to create new substantive rights and certainly not to create a massive and perpetual rate subsidy for a handful of customers.

It bears repeating: Not a single party appearing before the Commission - - including the customers taking service under Rider GCB - - thought to read Section 16-125A(b) as mandating a rate freeze until after the Commission's Order. If as CCB now contends, the plain meaning of Section 16-125A required that they be granted a continuing rate freeze, it is astounding they never once made that argument. The CTA also argues that Section 16-125A "is not ambiguous," but it too failed to invoke this statute at any time before the Order. These parties' failure to have done so proves conclusively that *they* are in no position now to invoke the "plain meaning" rule.

ComEd agrees the statute is clear and unambiguous: it allows for consolidated billing, nothing more.

Second, because the plain meaning of Section 16-125A fails to create a rate freeze, resort to rules of construction is unnecessary. But in any case those rules, too, cut against the CCB's position. Their argument, that a "cardinal" canon of statutory construction, namely that specific provisions control general, justifies a rate freeze is also flawed -- for two reasons. First, this particular canon is subordinate to more persuasive rules of construction and should only be used when those more reliable methods are unavailable. In this case, more reliable methods are available and none of them lead to something as implausible as a rate freeze. Second, this rule of construction is meaningless here: none of the conflicting sections is more specific or general than any other, so the question of which section "controls" does not arise.[31]

As noted in *People v. Arnhold*, 359 Ill. App.3d 857, 861 (2d. Dist. 2005),

> [T]here are clearer indicators of legislative intent than application of the principle that the specific controls the general. While that principle is a useful guide to construction, it is not talismanic and should not be applied mechanistically when to do so would defeat a legislative objective more plainly manifested in the language and structure of the applicable statutes as a whole.

In *Hearn v. American River Transp. Co.*, 303 Ill. App.3d 619 (5th Dist. 1999), cited by CCB (Reh.Br. at 4), the Court found a conflict between two federal statutes, FELA and the Jones Act. According to the Court, the Jones Act was more specific than FELA and the Jones Act provisions therefore took precedence. However, the Illinois Supreme Court in *Bowman v. American River Transp. Co.*, 217 Ill.2d 75 (2005), examining exactly the same provisions, interpreted the statutes so as to avoid any conflict and overruled *Hearn's* reading of the Jones Act. *See*, *Bowman*, at 90. In doing so, the Supreme Court made no use of the "specific over

[31] Indeed, as explained above, subsection (b) is subordinate to and merely explanatory of (a); it cannot be said to "control" (a) in any way.

general" doctrine at all. It did, however, focus on the actual language of the statutes and applied the presumption that the legislature did not intend to produce absurd, inconvenient or unjust results. *Id.*, at 83. It also applied a principle of construction known as "the last antecedent doctrine."[32] At no time did the Court see fit to mention, let alone apply, the canon of construction now relied on by CCB.

In this case, three superior methods of statutory construction all cut against the creation of a rate freeze. First, as noted here and elsewhere, the plain meaning of the statute does not, in fact, mandate a rate freeze. Second, statutes are to be read in such a way as to avoid conflict whenever possible. ComEd Reh.Br. at 53. The only way to do that here is to read the statutes in such a way as to restructure Rider GCB as Rider GCB7. Third, statutes are not to be read in such a way as to produce unjust, inconvenient or absurd results. *Id.* Contrary to CCB's "policy" arguments that is precisely the type of result their reading achieves. As Staff states in its Rehearing Brief, "[i]t is difficult to imagine anything more unreasonable and absurd then [sic] the governmental parties' position that the statute requires ComEd to provide service to them at a 1997 rate for ever into the future." Staff Reh.Br. at 59.

Further, even if one tries to resolve the statutory conflict by giving precedence to the more specific provision, the effort is futile because none of the relevant sections is more specific or general than any of the others. As the Court noted in *Arnhold*, at 862 "in any event, the defendant fails to explain why he believes that [one] statute is more specific than [the other]... neither is a subclass of the other." CCB's self-serving label of Section 16-125A(b) as "narrow" and Sections 16-108(c) and 16-111(i) as "very broad" does not make them so. CCB Reh. Br. at 4. The canon of construction relied upon by City/CCSAO/BOE does not mandate a rate freeze.

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[32] Whereby relative or qualifying words or phrases in a statute serve only to modify words or phrases which are immediately preceding and do not modify those which are more remote.

The CCB's final argument on statutory construction, that abolishing Rider GCB renders part of the statute superfluous or meaningless, is wrong. These parties do not point to one single word, phrase, clause or sentence in Section 16-125A that would be rendered meaningless or superfluous by the interpretation advanced by ComEd, Staff and IIEC. Indeed, it is only by violating this particular canon (ignoring the word "implementing" in Section 16-125A(b)) that CCB can construct a rate freeze interpretation at all. The CCB's statutory interpretation should be rejected. Rider GCB should be restructured as Rider GCB 7.

b. Method of recovery of any subsidy

i. Amount of Subsidy

No party disputes the amount of the subsidy to Rider GCB customers, which could be as high as $116 million annually. Crumrine/Alongi Reh.Dir., ComEd Ex. 57.0 Corr., 7:132-35. The CTA, however, asserts that it "has no way to verify ComEd's number." CTA/METRA Reh.Br. at 23-4. This is not true. ComEd provided the parties a detailed breakdown of its calculation of the subsidy. Crumrine/Alongi Reh.Dir., ComEd Ex. 57.0 Corr., 7:145-9:180; ComEd Ex. 57.1. While it is true that customer specific information was redacted (because ComEd is not free, by law, unilaterally to disseminate customer information), nothing prevented the CTA from verifying ComEd's methodology in calculating the subsidy. Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 8:162-73. Nor was the CTA prevented from sharing its information with other Rider GCB customers to verify ComEd's calculations.

The CTA's assertion that the calculation should have been limited to current Rider GCB customers also ignores the scope of rehearing. The Commission expressly requested that parties address the "potential" revenue shortfall on rehearing. Order at 236. Thus, it was necessary for ComEd to consider those customers who are expected to take service under Rider GCB.

Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 8:174-9:183. A heavily subsidized Rider GCB rate will result in more eligible customers opting to take service under this rider. *Id.* Thus, the number of customers currently taking service under Rider GCB simply fails to address the Commission's request.

Finally, the CTA's suggestion that the subsidy should not be collected until the precise amount is known does not make sense because the actual subsidy will be known at the time Rider GCB bills are issued. Failure to make provision now for recovery of the revenue shortfall that would result from the continuation of Rider GCB would represent an abdication of the Commission's responsibility to set rates that allow the utility a reasonable opportunity to recover its costs of providing service. *See Camelot Utilities, Inc. v. Ill. Commerce Comm'n.,* 51 Ill.App.3d 5, 9-10 (3rd Dist. 1977). For these reasons, the CTA's arguments should be rejected.

ii. Methods of Recovery

At the outset, it bears repeating that no party has questioned the Commission's determination (Order at 236) that ComEd should not be required to bear the burden of the subsidy created by the ruling on Rider GCB. ComEd and Staff agree that if the Commission's conclusion on Rider GCB is not changed, recovery of the subsidy should be localized. ComEd explained the basis for its position in its Initial Brief on Rehearing. ComEd Reh.Br. at 55-56. If the Commission disagrees with ComEd and Staff, then it should order that the subsidy be spread among all ComEd customers. Crumrine/Alongi Reh.Dir., ComEd Ex. 57.0 Corr., 11:238-12:250. The third method, favored by IIEC, is the least favorable because it would place an undue burden on residential and small commercial customers. Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 11:223-41; ComEd Reh.Br. at 56. Staff also favors this method of recovery the least. Staff Reh.Br. at 57-61.

3. Rider NS

A. Introduction

The Commission explicitly ordered subsidized distribution rates for the CTA and METRA (the "Railroads"). Order at 190. As a result these customers will pay a Distribution Facilities Charge ($2.35 per kilowatt) ("DFC") that is approximately ***one-half*** of the rate that these customers should pay based on ComEd's embedded cost of service study and the revenue requirement allowed in the Order, and substantially less than the current railroad DFC in Rate RCDS ($4.36 per kilowatt).[33] Not satisfied with this large subsidy, the Railroads now seek an even greater subsidy by increasing the standard service facilities that these customers are entitled to receive, and attempting to obtain automatic load transfer service (which requires reservation of distribution capacity) for free. These additional subsidies are unwarranted and would place even greater burdens on ComEd's other customers. For the reasons discussed below, ComEd strongly urges the Commission to refrain from creating additional subsidies for the CTA and METRA.

B. Standard Service

i. The Railroad's Contracts Provide That They Are Subject To Commission Modification

Initially, the Railroads attempt to cloud the issue of standard service by arguing that ComEd somehow is "unilaterally" amending their contracts. CTA/METRA Reh. Br. at 3-8. Nothing in the contracts guarantees the Railroads any rate design in perpetuity, or deprives the Commission of the authority to adopt rate designs proposed by parties to a rate case. The Order approved Rate BES-RR, which contains express language that supersedes conflicting provisions in the CTA and METRA contracts. Order at 190. Rate BES-RR was proposed with this

[33] The result of the low Railroad class' DFC rate is that the railroad Delivery Class bears just 51.2% of the costs assigned to it based on ComEd's embedded cost of service study and the revenue requirement approved by the Commission in the Order. ComEd Ex. 62.2, Step (A), Note (3).

language at the inception of this case. ComEd Ex. 10.1. The CTA filed testimony addressing Rate BES-RR and indeed ultimately favored approval of that Rate, as opposed to an alternative approach put forward by ComEd in response to their testimony seeking a greater standard of service than Rate BES-RR provides. Anosike Dir., CTA Ex. 1.0, 11:218-26; Anosike/Zika Reb., CTA Ex. 3.0, 28:683-29:702, 30:738-53; CTA Br. Exc. at 1-3, 8-10; CTA Rep.Br. Exc. at 2-3, 9-10.

Moreover, the Commission has the unquestioned authority to adopt a fair rate design for all its customers. *See City of Chicago v. People of Cook County,* 133 Ill. App.3d 435, 443 (1st Dist. 1985); *see generally, Central Ill. Public Service Co. v. Ill. Commerce Comm'n.,* 243 Ill. App.3d 421, 445 (4th Dist. 1993). The Railroads imply that their contracts in effect nullify the Commission's ratemaking authority. CTA/METRA Reh. Br. at 3-9. This argument, however, ignores express language in the contracts that specifically subjects them to the Commission's ratemaking authority. *See* Order at 190.[34] Because the contracts expressly provide that they are subject to Commission modification, Rate BES-RR does not violate the contracts in any way and the Commission's approval of this tariff was appropriate.

ii. The CTA's Contract Provides The Same Standard Of Service As Rate BES-RR

The Railroads' argument that their contracts were somehow violated by the Commission is more rhetorical excess. CTA/METRA Reh. Br. at 6-8. The fact is Rate BES-RR is consistent with the CTA's current contract because it also provides a single electric service station standard

[34] These provisions were set forth in footnote in ComEd's Initial Brief on Rehearing.

of service for the CTA's entire traction power system.[35] Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 13:267-76, 15:306-08. The Order expressly recognized this fact:

> The Commission understands that since 1998, the CTA has paid non-standard services and facilities charges for services based on the single electric service station standard consistent with Rate 6L and Rider 6. The CTA purchases service pursuant to an amendment to the contract negotiated with ComEd. Under the current arrangement, the CTA pays the energy charge listed in ComEd rate class 6L, the demand charges are consolidated under Rate GCB and the CTA also pays a reduced point of supply charge rather than the Railroad Class supply charge.

Order at 188 (emphasis added).[36] The CTA admits this to be true. *See* Tr. 1428:16-17; Tr. 1430:1-5. Accordingly, the Railroads' arguments regarding standard service are disingenuous and should be rejected outright.

iii. The Order Granted The Railroads The Appropriate Standard Of Service

The issue of standard service was thoroughly explored in the first phase of this proceeding and the Commission's decision to approve Rate BES-RR is fully supported by the record. *See* Alongi/McInerney Reb., ComEd Ex. 24.0, 38:962-39:997. The Railroads' eleventh hour attempt to recharacterize the issue as a construction cost issue is merely an attempt to obfuscate. CTA/METRA Reh. Br. at 4-8. Whether characterized as a construction cost issue or a nonstandard cost issue, the result is the same -- the Railroads are each entitled to a single electric service station standard of service for their entire traction power systems. This standard was proposed by ComEd in its initial filing, discussed extensively in testimony, and was

[35] ComEd notes that the Order clearly stated that "[i]n its initial filing in this Docket, ComEd proposed to maintain a separate delivery class for its two railroad traction power customers, CTA and METRA, and to provide bundled electric service for that railroad class under proposed Rate BES-RR – Basic Electric Service – Railroad (Rate BES-RR)." Order at 241. the Railroads' suggestion that the Order somehow is not clear on this issue is incorrect.

[36] As the Proposed Order acknowledges, under the 1998 amendment any ComEd additions to serve revisions of either railroad system would be considered non-standard, depending on the resulting total traction power system load, and subject to charges under Rider NS. Alongi/McInerney Reb., ComEd Ex. 24.0, 39:983-89; *see also* Crumrine/Alongi Sup. Reb., ComEd Ex. 47.0, 24:500-17. Since 1998, ComEd has applied and CTA has paid non-standard services and facilities charges for services based on the single electric service station standard consistent with rate 6L and Rider 6. *Id.*; Alongi/McInerney Sur., ComEd Ex. 41.0 Corr., 24:561-25:570.

approved in the Order. *See* Alongi/McInerney Dir., ComEd Ex. 10.0, 20:393-97; ComEd Ex. 10.1; Alongi/McInerney Reb., ComEd Ex. 24.0, 38:962-39:997; Alongi/McInerney Sur., ComEd Ex. 41.0 Corr., 24:561-25:570, 26:599-29:687; *see also* Order at 188-90, 241.

This single electric service station standard is especially fair in light of the highly subsidized DFC rate that these customers were granted in the Order. Specifically, the Order provides these customers with a DFC rate that is the same as that for a single contiguous Over 10 MW customer Located at a single contiguous premise. *Id.* The single electric service station standard of service is consistent with the standard facilities provided to such an Over 10 MW customer. Thus, the standard of service ordered for Railroads is entirely consistent with their treatment as a single contiguous Over 10 MW customer.

C. Reservation Of Distribution System Capacity

i. The Railroads Mischaracterize the Commission's Order

The Railroads misrepresent the Order on the issue of Reservation of Distribution System Capacity. CTA/METRA Reh.Br. at 10-11. The Order merely rejected ComEd's "language" relating to reservation of distribution system capacity, not the concept of charging for the additional facilities necessary to provide this service. *See* Order at 226. The Commission stated as follows:

> The Commission rejects the <u>language</u> in ComEd's proposed Rider NS related to reserved capacity charges and finds that the remaining provisions are adequate for ComEd to recover the cost of additional facilities necessary to provide non-standard service.

Id., emphasis added. The Order specifically allows ComEd to charge for "additional facilities necessary to provide non-standard service." *Id.* It cannot be disputed that ComEd must install "additional facilities" in order to provide automatic load transfer service. *See, e.g.*, Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 19:405-20:438; Tr. 391:6-16. It follows, therefore, that ComEd should charge for reservation of distribution system capacity on a case-by-case basis.

The record demonstrates that real costs are incurred in providing this automatic load transfer service. *See* ComEd Reh.Br. at 62-64; Crumrine/Alongi Reh.Reb., ComEd Ex. 62.0 Corr., 19:407-21:449; Alongi/McInerny Reb., ComEd Ex. 24.0, 20:507-23. Staff agrees that a real cost is associated with this nonstandard service and "ComEd is certainly entitled to recover its costs for such capacity." Hanson Dir., Staff Ex. 7.0, 9:192; Hanson Reb., Staff Ex. 18.0, 2:20-27. Even METRA conceded that "[t]here is no question there is some cost when a ComEd customer requests a second line for back-up power." METRA Reh. Br. at 9.

Accordingly, ComEd urges the Commission to leave this section of the Order as is and allow ComEd to charge for this service on a case-by-case basis. If a party believes that a particular charge is inappropriate, it has recourse before the Commission. However, if ComEd has misinterpreted the Order, then ComEd requests that the Order on Rehearing make an express exception to provide such service without charge <u>only for these two railroad customers</u>.

ii. The Railroads' Arguments Regarding A Reconciliation Provision In Rider NS Are Unfounded And Outside The Scope Of Rehearing.

The Railroads assert that the Rider NS formula does not contain an accounting reconciliation "*as required by statute*." CTA/METRA Reh. Br. at 13. However, the Railroads' do not identify what statute is violated. Nor do they ask the Commission for any relief. This argument should be disregarded as entirely unfounded.

Additionally, the Railroads' attempt to inject the Rider NS formula into the rehearing process should be rejected. It is outside the scope of rehearing, as it does not even remotely pertain to any of the four questions on which the Railroads' Petition for Rehearing was granted.

CTA/METRA Pet. for Reh. At 1. Furthermore, the assertion by the Railroads that the Commission ordered such reconciliation is incorrect. CTA/METRA Reh.Br. at 13. The Order did no such thing. *See* Order at 227.

iii. The Railroads' Claim That The Rider NS Formula Does Not Cover Reservation Of Distribution Capacity Is A Red-Herring

As noted above, the formula the Commission approved for Rider NS charges is not at issue on rehearing. The Railroads did not raise any issue with respect to this part of the Commission's Order in their Petition for Rehearing. *See* CTA/METRA Pet. for Reh. at 1. Accordingly, this section of the Railroads' brief should likewise be ignored.

The argument that reservation of distribution system capacity is not covered under the formula also is incorrect. CTA/METRA Reh.Br. at 12-13. The Railroads selectively quote Mr. Alongi's cross examination testimony that "the calculation of how much we reserve is not part of this rider, but that calculation of the cost to build the facility that replaces that capacity is what's in the rider." CTA/METRA Reh. Br. at 12. The Railroads, however, omit Mr. Alongi's cross examination testimony that the amount of capacity that must be reserved is a distribution system design question that ComEd planning engineers must address on a case by case basis in m much the same way as ComEd planning engineers must evaluate distribution system design requirements for any new service request. Tr. at 392:6-7, 393:11-396:15. Indeed, the Railroads acknowledge that the charges for this service relate to the facilities that must be constructed. What must be constructed in any particular case cannot possibly be determined in a vacuum but necessarily must be determined based on the specific circumstances and engineering design requirements. *See generally*, Tr., 393:1-396:15.

This section of the Railroads' brief demonstrates again that real costs are associated with the reservation of capacity. In particular, the questions asked of Mr. Alongi on cross examination clearly presuppose that providing automatic load transfer service requires the construction of new facilities. Tr., 387:15-396:15. Indeed, Mr. Alongi testified that he could not foresee any circumstances where a customer request for this service would not result in the construction of new facilities. Tr. 391:6-16.

CONCLUSION

For all the foregoing reasons, as well as for those stated in ComEd's Initial Brief on Rehearing, ComEd respectfully asks that the Commission enter an Order on Rehearing substantially in the form of the Proposed Order on Rehearing submitted by ComEd on November 14, 2006, incorporating the ordering paragraphs reflecting the ComEd/IIEC/DOE stipulation or, in the alternative, the paragraphs reflecting rejection of that stipulation.

Dated: November 21, 2006

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CERTIFICATE OF SERVICE

I, David M. Stahl, do hereby certify that a copy of the foregoing Commonwealth Edison Company's Reply Brief on Rehearing was served upon all parties on the attached Service List by the method so indicated this 21st day of November, 2006.

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David M. Stahl