ComEd Ex. 7.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
	:	No. 07-
Proposed general increase in electric rates	:	

Direct Panel Testimony of

KATHRYN M. HOUTSMA

Vice President, Regulatory Projects

and

STACIE M. FRANK

Director, Distribution Revenue Policy

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I. Introduction and Background

A. Identification of Witnesses

Q. What are your names and your business addresses?

A. Kathryn M. Houtsma, Commonwealth Edison Company, Three Lincoln Centre, Oakbrook Terrace, Illinois 60181.

Stacie M. Frank, Commonwealth Edison Company, One Financial Place, 440 South LaSalle Street, Suite 3300, Chicago Illinois 60605.

Q. Ms. Houtsma, by whom are you employed and in what capacity?

A. I am employed by Commonwealth Edison Company ("ComEd") as Vice President of Regulatory Projects.

Q. Ms. Frank, by whom are you employed and in what capacity?

A. I am employed by ComEd as Director of Distribution Revenue Policy.

B. Purpose of Testimony

Q. What is the purpose of your direct panel testimony?

A. The overall purpose of our direct panel testimony is to present, in detail, ComEd's delivery services revenue requirement (the "revenue requirement") and the components thereof, and to support certain of those components.

Q. How is your direct testimony organized?

A. Our direct testimony is divided into nine sections:

(1) this introductory section, which sets forth the scope of our testimony, summarizes our conclusions, identifies the attachments to our testimony, and presents our respective backgrounds and experience;

(2) ComEd's selection of the year 2006 as a "historical" test year, with certain appropriate adjustments, including *pro forma* adjustments;

(3) ComEd's total revenue requirement, reflecting ratemaking and *pro forma* adjustments;

(4) ComEd's rate base for purposes of determining the revenue requirement, reflecting ratemaking and *pro forma* adjustments;

(5) ComEd's operating expenses for purposes of determining the revenue requirement, reflecting ratemaking and *pro forma* adjustments;

(6) ComEd's miscellaneous revenues for purposes of determining the revenue requirement reflecting ratemaking and *pro forma* adjustments;

(7) the quantification and nature of the ratemaking and *pro forma* adjustments to rate base, operating expenses, and miscellaneous revenues;

(8) ComEd's Gross Revenue Conversion Factor; and

(9) a comparison of ComEd's revenue requirement and its components with the revenue requirement approved by the Illinois Commerce Commission (the "Commission" or "ICC") Commission in its Order on Rehearing in ComEd's last rate case, ICC Docket No. 05-0597.

Q. What do you mean by the terms "delivery services revenue requirement" and "revenue requirement" as used in your testimony?

A. In brief, we are using the terms "delivery services revenue requirement" and "revenue requirement" to mean the capital costs and operating expenses that ComEd incurs in order to distribute electricity and provide customer service to its retail customers in Illinois.[1]

Q. What do you mean by the term "historical test year"?

A. We use the term "historical test year" in accordance with our understanding of that term, as it is defined in 83 Ill. Adm. Code 287 ("Part 287"). In particular, Section 287.20 defines "historical test year" as a consecutive 12 month period, beginning no more than 24 months prior to the date of the utility's filing, for which actual data are available at the time of filing new tariffs.

Q. What do you mean by the term "*pro forma* adjustment"?

A. We use the term "*pro forma* adjustment" in accordance with our understanding of that term, as it is defined in Part 287. In accordance with Section 287.40, these adjustments reflect known and measurable changes in plant investment, operating revenues, expenses, and cost of capital where such changes occurred during the selected historical test year or are reasonably certain to occur subsequent to the historical test year but within 12 months after the filing date of the tariffs, and where the amounts of the changes are determinable.

C. Summary of Conclusions

Q. Please summarize the conclusions in your direct testimony.

A. In brief, we conclude as follows:

[1] The revenue requirement does not include costs and expenses recovered through riders, whether "flow through" riders or riders with charges and fees based on other calculations.

(1) ComEd's selection of the year 2006 as an "historical" test year, with certain ratemaking and *pro forma* adjustments, is proper and reasonable;

(2) The revenue requirement, including income taxes, is $2,048,826,000[2] (after the subtraction of miscellaneous revenues of $132,418,000);

(3) The revenue requirement represents an increase of $361,334,000 over revenues under current rates, driven largely by increases in plant investment and operating and maintenance expenses since the last proceeding;

(4) ComEd's rate base for purposes of determining the revenue requirement, with ratemaking and *pro forma* adjustments, is $7,071,234,000;

(5) ComEd's operating expenses for purposes of determining the revenue requirement, with ratemaking and *pro forma* adjustments, not including income taxes, are $1,357,528,000, and with income taxes, which are $219,125,000, are $1,576,653,000;

(6) ComEd's miscellaneous revenues for purposes of determining the revenue requirement, as indicated above, are $132,418,000; and

(7) ComEd's Gross Revenue Conversion Factor, excluding incremental uncollectible expense (the effect on uncollectible expense of the proposed revenue increase) and add-on revenue taxes, is 1.660. Including incremental uncollectible expense, the Gross Revenue Conversion Factor is 1.672.

D. Itemized Attachments to Direct Testimony

Q. What are the attachments to your testimony?

[2] The figures in the narrative portion of our testimony generally are rounded to the "thousands".

A. The following is a list of the exhibits attached to our testimony and a brief description of each.

(1) **ComEd Exhibit ("Ex.") 7.1** consists of 518 pages of Schedules that relate to several aspects of the foregoing subjects and that were required to be submitted to the Commission pursuant to its rate case informational requirements rules, 83 Ill. Adm. Code Part 285 ("Part 285").[3] More specifically, the Schedules in ComEd Ex. 7.1 are copies of certain Schedules filed with the Commission under Subparts D, E, and F of Part 285 as follows:

- Schedule As - Revenue and Financial Summary Schedules: A-1, A-2, A-2.1, A-4, and A-5;
- Schedule Bs – Rate Base Schedules: B-1, B-2, B-2.1, B-2.2, B-2.3, B-2.4, B-3, B-4, B-5, B-6, B-7, B-7.1, B-7.2, B-8.1, B-9, B-9.1, B-10, B-13, B-14, and B-15.
- Schedule Cs – Operating Income Schedules: C-1, C-2, C-2.1, C-2.2, C-2.3, C-2.4, C-2.5, C-2.6, C-2.7, C-2.8, C-2.9, C-2.10, C-2.11, C-2.12, C-2.13, C-2.14, C-2.15, C-2.16, C-2.17, C-2.18, C-2.19, C-3, C-4, C-5, C-5.1, C-5.2, C-5.3, C-5.4, C-5.5, C-6.1, C-7, C-8, C-10 (PUBLIC), C-10.1, C-11.1, C-11.2a, C-11.2b, C-11.3, C-11.4, C-12, C-14, C-16, C-18, C-19, C-20, C-21, C-23, C-24, C-25, C-26, and C-29.

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[3] Part 285, in addition to requiring the filing of specified information and documents with the Commission, also requires that other extensive materials -- such as independent auditor work papers, board of director meeting minutes, tax returns, accounting policies, and information regarding employee incentive compensation -- be made available for inspection. ComEd has assembled those materials, consisting of roughly 4,100 pages, for inspection. ComEd also voluntarily has compiled still further materials relating to subjects in rate case filing, consisting of roughly 11,400 pages, for inspection, and is making those materials available in a data room.

(2) **ComEd Ex. 7.2** consists of 133 pages of certain associated work papers that support the Part 285 Schedules included in ComEd Ex. 7.1, as referenced on the work papers. Unless otherwise noted, the Schedules and work papers in ComEd Exs. 7.1 and 7.2 have been prepared by us or under our direct supervision. To the best of our knowledge and belief, the Schedules and work papers are accurate.

(3) **ComEd Ex. 7.3** provides a breakdown of the individual expense categories included in Administrative & General ("A&G") expenses in the revenue requirement and the changes in those amounts versus the Commission's Order on Rehearing in ComEd's last rate case, ICC Docket No. 05-0597.

(4) **ComEd Ex. 7.4** provides details regarding the differences between A&G expenses amounts identified in the Direct Testimony of independent expert Thomas Flaherty (ComEd Ex. 8.0) and the amounts included in the revenue requirement.

E. Background and Experience

Q. Ms. Houtsma, what are your duties in your current position with ComEd?

A. As Vice President of Regulatory Projects, my responsibilities include providing financial expertise and support in various regulatory proceedings, and oversight of the ComEd transmission pricing function.

Q. Ms. Houtsma, what were your prior positions with ComEd and its affiliates?

A. I began my employment with ComEd in 1979, and have held a variety of staff and managerial positions in the financial, accounting, and regulatory areas for ComEd and certain of its affiliates. Those positions (with ComEd unless otherwise noted) include Director of Revenue Requirements, Director of Regulatory Affairs, Director of Investor

Relations, Manager of Financial Reporting, Vice President of External Reporting (Exelon Corporation), Vice President and Controller, and Vice President – Finance (Exelon Energy Delivery Company, LLC).

Q. Ms. Houtsma, what is your educational background?

A. I was awarded a Bachelors of Business Administration in Accounting from St. Mary's College in 1979 and a Masters of Management from Northwestern University's Kellogg Graduate School of Management, with a concentration in Finance, in 1983. In 1979, I became a Certified Public Accountant in the State of Illinois.

Q. Ms. Frank, what are your duties in your current position with ComEd?

A. As Director, Distribution Revenue Policy, my responsibilities include the quantification of delivery services rate base, operating expenses, and miscellaneous revenues applicable to the provision of delivery services.

Q. Ms. Frank, what were your prior positions with ComEd and its affiliates?

A. From 2002 to 2006, I served as Senior Financial Analyst; Manager, Finance; and Director, Finance, in the Corporate Treasury Department of Exelon Corporation. From 1997-2000, I held positions outside of the Exelon Corporation family of companies. From 2000-2002, I was conducting graduate studies on a full-time basis.

Q. Ms. Frank, what is your educational background?

A. I was awarded a Bachelor of Science Degree in Business Administration, with a Major in Finance, from Villanova University in 1997. I was awarded a Masters of Business Administration Degree from the University of Chicago Graduate School of Business with concentrations in Finance, Accounting and Economics in 2002.

II. Test Year

Q. What is the test year that ComEd is using in this proceeding?

A. ComEd is using a 2006 historical test year, with ratemaking and *pro forma* adjustments, in this proceeding.

Q. Why is ComEd using the 2006 test year, with adjustments, for ratemaking purposes in this proceeding?

A. ComEd operates on a calendar year basis for financial reporting purposes. The year 2006 is the most recent calendar year for which ComEd has complete results. Also, each year ComEd is required to prepare and file with the Federal Energy Regulatory Commission ("FERC") a "FERC Form No. 1: Annual Report of Major Electric Utilities, Licensees and Others", commonly referred to as the FERC "Form 1". The FERC Form 1 uses the FERC Uniform System of Accounts, which has been adopted by the ICC with limited modifications (the "USOA"). ComEd's most recent FERC Form 1 is for the year 2006. The FERC Form 1 is the starting point in most respects for the development of the revenue requirement in an historical test year case.

Certain adjustments to the 2006 data are appropriate for the determination of the revenue requirement in this proceeding, as we will discuss below. Thus, in our opinion, for each of the above reasons, use of the 2006 test year, with appropriate adjustments, is the appropriate approach for this proceeding among the available regulatory options and given the available data.

Q. What criteria was used to determine ratemaking and *pro forma* adjustments to the actual 2006 historical test year costs?

A. In brief, the ratemaking adjustments and reclassifications are based on the appropriate application of established ratemaking and accounting principles. Similarly, the *pro forma* adjustments are based on the established standards for such adjustments. The adjustments are discussed and reflected in our testimony below and in ComEd Exs. 7.1 and 7.2.

III. <u>The Total Revenue Requirement</u>

Q. What is ComEd's revenue requirement in this proceeding?

A. ComEd's revenue requirement in this proceeding is $2,048,826,000 (after the subtraction of miscellaneous revenues), as shown on ComEd Ex. 7.1, Schedule C-1, page 1, line 1, column (G). The weighted average cost of capital (also referred to as the "rate of return") that is reflected in the determination of the revenue requirement is discussed in the Direct Testimony of Robert McDonald (ComEd Ex. 9.0) and Samuel Hadaway (ComEd Ex. 10.0). The rate base and operating expenses included in the determination of the revenue requirement are supported as to their prudence, reasonableness in terms of cost, used and useful status of plant in providing distribution and customer service, and need in terms of providing such service primarily by the Direct Testimony of George Williams (ComEd Ex. 4.0), Michael McMahan (ComEd Ex. 5.0), Sally Clair (ComEd Ex. 6.0), Robert McDonald (ComEd Ex. 9.0), and independent expert Thomas Flaherty (ComEd Ex. 8.0), although certain components are primarily or secondarily supported by our testimony. Our testimony is the primary testimony on the quantification and functionalization of all components.

Q. In brief, what methodology did ComEd use to determine its revenue requirement?

A. ComEd's revenue requirement, with certain exceptions, generally includes and reflects:

(1) costs recorded in Distribution, Customer Accounts, and Customer Service and Information Accounts under the USOA as adopted by FERC and modified by the Commission;

(2) the portions of costs recorded in Accounts other than Distribution, Customer Accounts, and Customer Service and Information Accounts under the USOA that are costs of offering and providing distribution and customer service, such as the applicable costs recorded in Administrative and General Expenses, Depreciation and Amortization Expenses, Taxes Other Than Income, Income Taxes, and General Plant and Intangible Plant Accounts;

(3) ratemaking adjustments and reclassifications;

(4) *pro forma* adjustments; and

(5) the cost of capital (the application of the rate of return to rate base).

The foregoing capital costs and operating expenses were reviewed in order to determine what costs and expenses should be included in the revenue requirement and to comply with Part 285.

The revenue requirement is reduced by the annualized revenue requirement associated with the costs and expenses of providing limited wholesale distribution service to reselling municipalities subject to FERC jurisdiction.

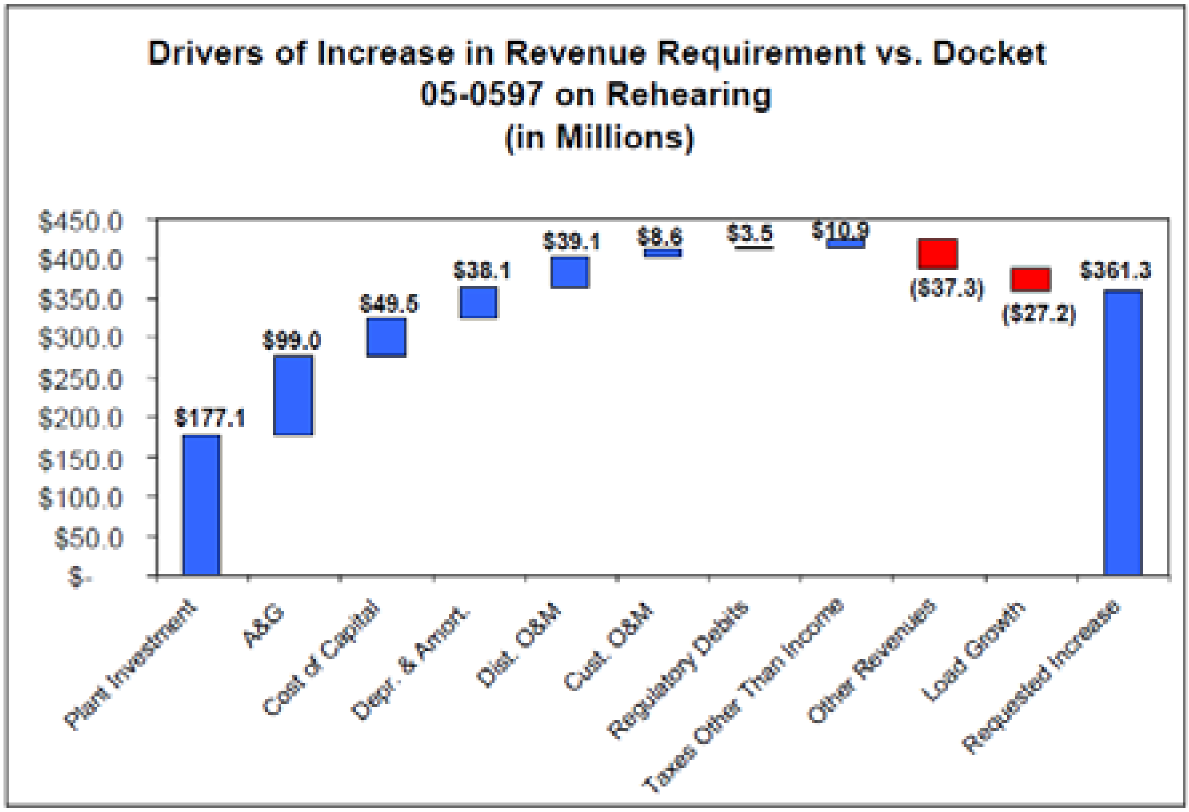
The revenue requirement represents the capital costs and operating expenses to be recovered through the Customer, Standard Metering Service, and Distribution Facilities Charges in ComEd's proposed revised basic electric service ("BES") and delivery services rates. ComEd's proposed revised tariffs, which reflect the revenue requirement we are presenting, are discussed by other ComEd witnesses. See the Direct Testimony of Paul R. Crumrine (ComEd Ex. 11.0), Lawrence S. Alongi and Chantal K. Jones (ComEd Ex. 12.0), and independent expert Alan P. Heintz (ComEd Ex. 13.0).

Q. How does the revenue requirement compare to the revenue requirement approved by the Commission in its Order on Rehearing in ComEd's last rate case, ICC Docket No. 05-0597?

A. The revenue requirement of $2,048,826,000 represents an increase of $388,522,000 over the revenue requirement of $1,660,304,000 approved by the ICC in the Order on Rehearing in ComEd's last rate case. After considering the increase in load growth from 2004 (the test year in that case) to 2006, which increases the billing determinants to which the revenue requirement will be applied to determine rates, the revenue increase is $361,334,000, or 21.4%, above revenue under current delivery service rates of $1,687,492,000.

Q. What are the primary drivers of the increase?

A. The factors leading to an increase in the revenue requirement are shown in the following graph and are described in more detail in Section IX of our testimony.



IV. Rate Base

A. Total Rate Base

Q. As of what period or date is ComEd's delivery services rate base determined?

A. Rate base is determined as of December 31, 2006, with ratemaking and *pro forma* adjustments.

Q. What is ComEd's delivery services rate base?

A. ComEd's delivery services rate base, determined as of December 31, 2006, with ratemaking and *pro forma* adjustments, which are described later in this testimony, is $7,071,234,000 as shown in ComEd Ex. 7.1, Schedule B-1, page 1, line 19, column (D). Based on the information provided in the testimony of ComEd witnesses Mr. Williams (ComEd Ex. 4.0), Mr. McMahan (ComEd Ex. 5.0), and Ms. Clair (ComEd Ex. 6.0), the investment in rate base as set forth on the applicable Schedules attached hereto in ComEd Ex. 7.1 (and in Subpart E of ComEd's Part 285 filing) is prudent and reasonable and used and useful and is appropriate for purposes of determining the revenue requirement.

Q. What categories of rate base items has ComEd placed in its rate base as of December 31, 2006, including adjustments?

A. In brief, ComEd's rate base includes:

(1) costs recorded in Distribution Plant Accounts under the USOA, such as land, poles, cable, transformers, and meters as of December 31, 2006;

(2) costs of Distribution Plant additions that have been placed in service or are reasonably expected to be placed in service by the end of the third quarter of 2008;

(3) costs recorded in General Plant and Intangible Plant Accounts that support the provision of distribution and customer service, such as office furniture, vehicles, stores equipment, and capitalized software as of December 31, 2006;

(4) costs of the portion of General Plant and Intangible Plant additions that have been placed in service or are reasonably expected to be placed in service by the end of the third quarter of 2008 that support the provision of distribution and customer service; and

(5) other assets and liabilities that pertain to the appropriate level of capital investment required to provide distribution and customer service, as discussed below.

B. Electric Utility Plant In Service At Original Cost

Q. How did ComEd calculate the appropriate level of electric utility plant in service at original cost included in rate base?

A. The level of *gross* investment in electric utility plant in service at original cost included in ComEd's rate base as of December 31, 2006, *before* adjustments, is $12,147,135,000, comprised of $11,041,608,000 of Distribution Plant, plus $1,105,527,000 of General Plant and Intangible Plant as shown in ComEd Ex. 7.1, Schedule B-1, page 1, lines 2 through 4, column (B).

The level of *net* investment, *after* appropriate adjustments, is $8,621,744,000, comprised of $7,817,668,000 of Distribution Plant, plus $804,076,000 of General Plant and Intangible Plant, as shown in ComEd Ex. 7.1, Schedule B-1, page 1, column (D), lines 2 through 8. *See* Section IV(C) of our testimony, below, for additional information relating to General Plant and Intangible Plant. *See* Section VII(A) of our testimony, below, regarding the adjustments, including *pro forma* adjustments, affecting electric utility plant in service.

The Distribution Plant and General and Intangible Plant included in rate base, including the facts that such plant was prudently acquired at reasonable cost, and is used and useful in providing distribution and customer service, is addressed in the Direct Testimony of ComEd witnesses Mr. Williams, Mr. McMahan, and Ms. Clair (ComEd Exs. 4.0, 5.0, and 6.0, respectively).

C. Functionalization Of General Plant And Intangible Plant

Q. How was the portion of General Plant and Intangible Plant that is included in rate base determined?

A. ComEd's General Plant (which is recorded in FERC Accounts 389-399) includes costs that generally support or relate to one or more of ComEd's three business functions, *i.e.*, the transmission, distribution, and customer functions. Costs included in these Accounts are diverse in nature and include items such as land and office buildings in which personnel who carry out those functions work, office furniture and equipment, transportation equipment such as vehicles used by meter readers, tools, and communication equipment such as telecommunications equipment used by distribution system maintenance personnel and Supervisory Control and Data Acquisition ("SCADA") equipment used to monitor and improve system reliability.

ComEd's Intangible Plant (which is recorded in FERC Accounts 301-303) includes costs of capitalized software for computer systems that generally support or relate to one or more of the above three functions, such as computer systems used in relation to work on the transmission and distribution systems and to provide customer service and billing.

ComEd performed a study of its General Plant and Intangible Plant items to identify which of ComEd's three business functions required these investments and in what amounts.

Q. Please generally describe the study of ComEd's General Plant and Intangible Plant.

A. The study of ComEd's General Plant and Intangible Plant employs the same approach that it used, and that was approved by the Commission, in ComEd's 2005 rate case, ICC Docket No. 05-0597. ComEd used direct assignment of General Plant and Intangible Plant items where it could reasonably be done. Otherwise, the costs were allocated using an appropriate cost-causative allocation factor, such as the salary and wages allocator, commonly referred to as the "general labor allocator," or a gross plant allocator. A detailed summary of the study's results is set forth in ComEd Ex. 7.2, WPB-1, while the calculation of the general labor allocator is set forth in ComEd Ex. 7.2, WPA-5. The general labor allocator distributes 88.8% of ComEd's costs to the delivery services function.

Q. What were the results of the study of ComEd's General Plant and Intangible Plant in terms of the analysis of each individual General Plant and Intangible Plant Accounts?

A. The results of the study of General Plant in terms of the analysis of each of the individual Accounts may be summarized as shown in the following chart:

General Plant

FERC Account	Title	Description	Gross Amount Supporting Distribution	Functionalization Method
389	Land and Land Rights	Land parcels and land rights associated with ComEd's business headquarters and support functions. Also included are land parcels associated with freestanding communications facilities	$7,207,000	Square Footage Occupied by business function
390	Structures and Improvements	Structure and improvements associated with ComEd's business headquarters, support functions, as well as its regional, area and district operations. Also included are any structures and improvements associated with freestanding communication facilities.	$206,247,700	Square Footage Occupied by business function
391	Office Furniture & Equipment	Office furniture, personal computers, personal computer network components and office machines	$90,007,000	General Labor
392	Transportation Equipment	Primarily vehicles, such as vehicles used by meter readers.	$136,063,000	February 2007 Analysis of Transportation Assets
393	Stores Equipment	Equipment located in ComEd's storerooms and warehouses	$6,846,000	General Labor
394	Tools, Shop and Garage Equipment	Tools, shop and garage equipment located at or on the business unit's facilities and vehicles	$83,497,000	Percentage of Total Gross Plant
395	Laboratory Equipment	Laboratory equipment used to test various ComEd Equipment, such as meters and transformers	$8,707,000	Percentage of Total Gross Plant
396	Power Operated Equipment	Power-operated equipment used by the business unit, such as compressors, trenchers, and diggers	$6,463,000	Percentage of Total Gross Plant
397	Communication Equipment	Includes communications equipment such as microwave systems, audio tone systems, SCADA e-systems, and radio and telephone systems	$307,593,000	Location of Equipment
398	Miscellaneous Equipment	Miscellaneous Equipment	$1,400,000	General Labor
399	Other Tangible Property		$0	
399.1	Asset Retirement Costs for General Plant	Includes an accounting adjustment related to the accrual of removal costs.	Excluded from rate base as removal costs are recovered through the depreciation rate	

The results of the study of ComEd's Intangible Plant in terms of the analysis of each of the individual Accounts may be summarized as shown in the following chart:

Intangible Plant

FERC Account	Title	Description	Gross Amount Supporting Distribution	Functionalization Method
301	Non-Depreciable	Costs to incorporate	$71,000	General Labor
302	Franchises and Consents		$0	
303	Intangible Plant	The plant recorded in this Account relates to capitalized software that represents the major computerized operating systems at ComEd (CEGIS, Mobile Data, PassPort, Power Tools, CIMS) and miscellaneous software.	$251,426,000	Direct Assignment

D. <u>Accumulated Provisions For Depreciation And Amortization</u>

Q. What is the level of accumulated provisions for depreciation and amortization of electric utility plant in service as of December 31, 2006, with appropriate adjustments, subtracted from gross plant when calculating rate base?

A. The level, before adjustments, of accumulated provisions for depreciation and amortization of electric utility plant (commonly referred to as the "Depreciation Reserve") as of December 31, 2006, subtracted from gross plant when calculating rate base is $5,030,255,000 (ComEd Ex. 7.1, Schedule B-1, page 1, line 8, column (B)). The level, after appropriate adjustments, is $4,598,992,000, as shown in ComEd Ex. 7.1, Schedule B-1, page 1, line 8, column (D). See Section VII(A) of our testimony for information regarding the adjustments, including *pro forma* adjustments, affecting the accumulated provisions for depreciation and amortization.

E. <u>Construction Work In Progress</u>

Q. Is any Construction Work In Progress ("CWIP") included in rate base?

A. Yes. Rate base includes ComEd's investments in small or short-term projects that support the distribution and customer functions, on which Allowance for Funds Used During Construction ("AFUDC") is not being capitalized. The amount as of December 31, 2006, was $39,502,000. *See* ComEd Ex. 7.1, Schedule B-7, line 3, column (B). It is important to note that ComEd is not seeking inclusion as such of the specific projects that were recorded in CWIP as of year-end 2006. Rather, the overall level of CWIP that does not accrue AFUDC as of December 31, 2006 is included, and is lower than the amounts expected to be incurred in future periods.

F. <u>Accumulated Deferred Income Taxes</u>

Q. What is the level of Accumulated Deferred Income Taxes ("ADIT") to be deducted from rate base?

A. The appropriate level of ADIT to be deducted from rate base, before adjustments, is $1,319,071,000, as shown in ComEd Ex. 7.1, Schedule B-1, page 1, line 11, column (B). The appropriate level, after adjustments, is $1,325,618,000, as shown on ComEd Ex. 7.1, Schedule B-1, page 1, line 11, column (D). This level was derived through an analysis of the components of the deferred tax balances and then either by directly assigning or allocating the items based on the assignment or allocation of the operating items to which they relate. See also Section VII(A), below, for further information in connection with the adjustments, including *pro forma* adjustments, affecting the level of ADIT.

G. <u>Accumulated Pre-1971 Investment Tax Credits</u>

Q. Are accumulated pre-1971 investment tax credits deducted from rate base?

A. Yes. In ICC Docket No. 83-0537, the Commission ordered that unamortized deferred investment tax credits generally associated with property acquired prior to 1971 should be deducted from rate base. As a result, $20,000 of accumulated pre-1971 investment tax credits related to distribution property as of December 31, 2006 have been deducted from rate base, as shown in ComEd Ex. 7.1, Schedule B-1, page 1, line 18.

H. Materials and Supplies

Q. How was the amount of Materials and Supplies included in rate base determined?

A. Materials and Supplies inventories of $44,401,000 have been directly assigned to the distribution function based on internal records that identify inventories by location and category codes. These inventories are maintained for construction, operation and maintenance purposes, to support the provision of distribution service. The year-end balance of Materials and Supplies has been reduced by $7,005,000 to reflect the estimated accounts payable balance at year-end related to the inventory included in rate base. The adjusted Materials and Supplies amount included in rate base is $37,396,000, as shown in ComEd Ex. 7.1, Schedule B-1, page 1, line 10. The level of Materials and Supplies included in rate base is supported by Mr. Williams (ComEd Ex. 4.0).

I. Deferred Charges

Q. What is the deferred debit included in ComEd's rate base?

A. The deferred debit, after adjustments, included in rate base is a regulatory asset representing the unamortized balance of $9,432,000 for capitalized incentive costs approved by the Commission in its Order in ComEd's 2001 rate case, ICC Docket No. 01-0423, as shown in Schedule B-10, page 1, line 2. Consistent with the Commission's Order on Rehearing in ICC Docket No. 05-0597, the pension contribution addressed in that Docket is not included in rate base, but a debt-only return is included in operating expenses, as described later in our testimony and in ComEd Ex. 7.2, WPC-2.18.

Q. What are the deferred credits included in rate base?

A. The deferred credits, after adjustments, included in rate base are:

(1) Operating reserves for injuries and damages of $56,360,000;

(2) Post-retirement benefits of $188,177,000;

(3) Other miscellaneous environmental liabilities of $8,496,000;

(4) Asset Retirement Obligations of $36,195,000 recorded in Account 230 representing asset removal costs recovered through depreciation expense (these costs were previously recorded in Account 108- Accumulated Depreciation and were reclassified in 2005 in accordance with the Uniform System of Accounts);

(5) Deferred Rents of $12,452,000; and

(6) Deferred benefits for tax deductions sold of $4,446,000.

These items are shown in ComEd Ex. 7.1, Schedule B-10, page 2.

J. <u>Cash Working Capital</u>

Q. Has ComEd included any cash working capital in rate base?

A. No. Consistent with not including any amount for cash working capital and with the ICC's Order in ComEd's last rate case, ComEd also has not included any rate base adjustment for budget payment plan balances or for customer deposits.

K. <u>System Modernization Rider</u>

Q. Mr. Mitchell, Mr. Williams, Ms. Clair, and Mr. Crumrine (ComEd Exs. 1.0, 4.0, 6.0, and 11.0, respectively) each discuss ComEd's proposal for a system modernization projects ("SMP") rider. Does ComEd's rate base, or its revenue requirement, include any of the costs that ComEd may seek to recover through the SMP rider?

A. No. The SMP rider and SMP proposal applies to projects beginning with the fourth quarter of 2008. None of the costs to be incurred in that quarter or thereafter are included in ComEd's rate base or its revenue requirement.

Q. If the SMP rider is approved, how will costs be calculated under the rider?

A. Costs will be calculated under the SMP rider the same way that they are calculated when incorporating CWIP or *pro forma* adjustments for capital additions in a revenue requirement for a rate case. For the period of time that the project costs are in CWIP (*i.e.*, from the time the investment is made until the project is placed in service) the cost calculations will represent a return on investment based on ComEd's approved rate of return (the cost of capital set in this or its most recent general rate case). Once a project is placed in service, the amount included in the rider will include both a return of and on the investment, reflecting its applicable depreciation rates in calculating the return of and return on these projects, including the associated depreciation reserve and depreciation expenses for the projects, state and federal income tax rates, and the gross revenue conversion factor (set in this or its most recent general rate case).

Q. ComEd's rate base includes $39,502,000 of CWIP. How will it be assured that the inclusion of CWIP related to the SMP rider projects are not double-counted?

A. The $39,502,000 of CWIP in rate base represents small or short-term projects that do not meet the criteria for capitalization of AFUDC. To avoid any potential for double-counting, only those projects that are otherwise eligible for AFUDC will be included in the rider during construction (although AFUDC will not be applied due to their inclusion in the rider). If a project is not eligible for AFUDC, those costs will be included in the rider at the time the project is placed in service.

Q. At the time of its next general rate case, how will the costs recovered under the SMP rider be taken into account?

A. ComEd anticipates including the costs of the applicable projects in rate base and simultaneously removing those projects from the rider. The calculations will ensure that there is no double-recovery of any costs recovered under the SMP rider.

V. Operating Expenses

A. Total Operating Expenses

Q. What are ComEd's total delivery services operating expenses for the purposes of determining the revenue requirement in this proceeding?

A. ComEd's delivery services operating expenses determined as of December 31, 2006, with appropriate adjustments, are $1,576,653,000 including $219,125,000 of income taxes, as shown in ComEd Ex. 7.1, Schedule C-1. Based on the information provided in the testimony of Mr. Williams, Mr. McMahan and Ms. Clair (ComEd Exs. 4.0, 5.0, and 6.0, respectively) and herein, the delivery services operating expenses set forth on that Schedule were prudently incurred, necessary, reasonable in amount, and are appropriate for purposes of determining the revenue requirement.

Q. What categories of delivery services operating expenses, reflecting adjustments, including *pro forma* adjustments, are included in the revenue requirement?

A. Briefly, ComEd's expenses included in the revenue requirement include:

(1) expenses recorded in Operating and Maintenance ("O&M") Accounts under the USOA that are functionalized to the distribution function;

(2) the portion of expenses recorded in other O&M Accounts that are customer-related and that appropriately are assigned or allocated to the delivery services function; and

(3) the portion of expenses recorded in other FERC Accounts, other than distribution and customer-related Accounts, that appropriately are assigned or allocated to the delivery services function, including Administrative and General (A&G) Expenses, Depreciation and Amortization Expenses, Taxes Other Than Income Taxes, and Income Taxes.

These categories of expenses are described in further detail below.

B. <u>Distribution O&M Expenses</u>

Q. Generally, what do you mean when you refer to distribution O&M expenses?

A. Distribution O&M expenses are expenses recorded in FERC Accounts 580 through 598, which directly relate to the distribution function.

Q. What amount of distribution O&M expenses is appropriately included in the revenue requirement?

A. Distribution O&M expenses in ComEd's year 2006 FERC Form 1 were $315,590,000. After reflecting adjustments, including *pro forma* adjustments, a total of $309,310,000 in distribution O&M expenses recorded in FERC Accounts 580-598 is appropriately included in the revenue requirement. The quantification and the prudence, reasonableness and need of and for these expenses are addressed by Messrs. Williams and McMahan (ComEd Exs. 4.0 and 5.0, respectively). *See* ComEd Ex. 7.1, Schedules C-1, C-2, and C-4.

C. Customer-Related Expenses, Including Uncollectible Accounts Expense

Q. Generally, what do you mean when you refer to customer-related O&M expenses?

A. Customer-related expenses are expenses recorded in FERC Accounts 901-910, which include the costs of maintaining and servicing customer accounts, *e.g.*, meter reading, customer service, and billing and credit activities.

Q. What amount of customer-related expenses is appropriately included in the revenue requirement?

A. Customer-related expenses in ComEd's 2006 FERC Form 1 were $179,273,000. In determining the revenue requirement, ComEd has adjusted these for the following ratemaking and *pro forma* items:

(1) $7,987,000 reduction for costs of ComEd's CARE (Customers' Affordable Reliable Energy) program, which are not being recovered through rates;

(2) $112,000 reduction for certain costs that are being recovered through ComEd's Supply Administration Charges;

(3) $13,000 reduction for certain industry association dues for which recovery is not being sought;

(4) $21,408,000 reduction to reflect the non-jurisdictional portion of uncollectible accounts expense and outside collection agency costs;

(5) $2,638,000 increase to reflect the increase in uncollectible accounts expense related to the proposed rates; and,

(6) $4,562,000 increase to reflect *pro forma* adjustments more fully detailed on ComEd Ex. 7.1, Schedule C-2.

Including these adjustments, $156,953,000 of FERC Accounts 901-910 directly relate to and support the delivery services function and are included in the revenue requirement as shown in ComEd Ex. 7.1, Schedule C-1, page 1, lines 9-10, column (G). The quantification, the prudence, reasonableness and the need for these expenses is addressed further in the Direct Testimony presented by Ms. Clair (ComEd Ex. 6.0).

Q. What level of uncollectible accounts expense is appropriately included in the revenue requirement?

A. The $156,953,000 of customer-related expenses described above includes $14,885,000 of uncollectible accounts expense. Uncollectible accounts expense is generally a function of revenues billed and has been assigned to the delivery services function based on an analysis of 2006 uncollectible accounts expense by customer class. As a result of that study, delivery services uncollectible expenses are $12,247,000 of the $33,021,000 of ComEd's total 2006 uncollectible accounts expense. (*See* ComEd Ex. 7.1, Schedule C-16.) The revenue requirement also includes $2,638,000 of incremental uncollectible accounts expense related to the proposed revenue increase, as previously described. These expenses are also addressed further in the direct testimony presented by Ms. Clair (ComEd Ex. 6.0).

D. <u>Administrative and General Expenses</u>

Q. What types of expenses are included in the Administrative and General Expenses category?

A. Under the USOA, A&G Expenses are recorded in Accounts 920-935. Costs included in those Accounts generally represent a wide variety of corporate support and overhead costs that benefit or derive from more than one business function. Major A&G support areas include Human Resources, Finance, Legal, Supply Management, Information Technology, and Corporate Governance functions. Additionally, the costs of employee pensions and benefits, including health care for active and retired employees, as well as rents, injuries and damages expenses, and regulatory expenses are included in these A&G Accounts.

Q. Who provides the services covered by Administrative and General Expenses?

A. In general, services are provided either internally by ComEd employees or by other service providers, including Exelon Business Services Company ("EBSC"). EBSC provides corporate governance, technical, and numerous other support services to the Exelon companies. These services are provided to ComEd under the terms of the General Services Agreement approved by the ICC and the Securities and Exchange Commission. Costs for these services are directly charged to ComEd where possible, and if costs cannot be directly charged, they are allocated to ComEd and the other Exelon affiliates utilizing cost-causative allocation factors. In all cases, services provided by EBSC are billed to ComEd at cost (*i.e.*, with no mark-up). EBSC expenses incurred by ComEd are addressed by independent expert Thomas Flaherty (ComEd Ex. 8.0).

Q. What is the amount of Administrative & General expenses reported in ComEd's 2006 FERC Form 1?

A. ComEd's total unadjusted A&G expenses as reported in its 2006 FERC Form 1 are $182,338,000, but certain adjustments must be made to the 2006 FERC Form 1 A&G expenses to accurately reflect ComEd's delivery services A&G expenses for the test year. ComEd Ex. 7.3 provides a breakdown of the individual cost categories included in A&G

expenses, and the changes in those amounts versus the Commission's Order on Rehearing in ComEd's last rate case, ICC Docket No. 05-0597.

Q. What adjustments need to be made to the 2006 FERC Form 1 A&G expenses to accurately reflect ComEd's delivery services A&G expenses?

A. A number of adjustments are made to A&G expense to reflect the appropriate amount of A&G associated with delivery services during the test year. In addition to a number of *pro forma* test year adjustments which are described in more detail in Section VII(B) of our testimony, 2006 costs reported in the Form 1 have been adjusted to remove accounting credits of $158,000,000 and $46,527,000 that were recorded in 2006 to reflect the establishment of regulatory assets related to previously incurred severance and manufactured gas plant ("MGP") remediation costs that the Commission's order in ICC Docket No. 05-0597 provided recovery for in future rates. *See* ComEd Ex. 7.2, WPC-1a, page 1.

Q. Once ComEd determined the appropriate total amount of A&G expenses to functionalize between its business functions, what method was used to determine the A&G expenses to be included in the revenue requirement?

A. The functionalization of the appropriate total A&G expenses amount is based on the 2006 relationship of total ComEd delivery services (distribution and customer-related) wages and salaries included in O&M expenses to the total ComEd wages and salaries included in O&M expenses, *i.e.*, the general labor allocator. This method is consistent with the approach used by ComEd and approved by the Commission in ICC Docket No. 05-0597. *See* ComEd Ex. 7.2, WPC-1a.

Q. What amount of A&G expenses is appropriately included in the revenue requirement?

A. After reflecting the *pro forma* and ratemaking adjustments described in Section VII(B) of our testimony, the amount of A&G expenses attributable to delivery services and appropriately included in the revenue requirement is $341,301,000 as shown in the chart below. We explain the main drivers of the changes in A&G levels in Section IX of our testimony. These expenses are also addressed further by Mr. Williams (ComEd Ex. 4.0).

A&G Expense By FERC Account	(In 000s)
920/921 A&G Salaries/Office Supplies & Expenses	$42,377
922 Admin Expenses Transferred - Credit	($14,619)
923 Outside Services Employed	$143,491
924 Property Insurance	$907
925 Injuries & Damages	$14,455
926 Employee Pensions	$99,423
927 Franchise Requirements	$0
928 Regulatory Commission Expense	($2,025)
929 Duplicate Charges-Credit	$0
930.1 General Advertising Expense	$0
930.2 Misc. General Expenses	$14,214
931 Rents	$27,737
Total Operation	$325,959
Maintenance	
935 Maint. Of General Plant	$15,342
Total A&G Expenses	$341,301

Q. How do these figures compare with the amounts discussed in the testimony of Mr. Flaherty?

A. Mr. Flaherty evaluated total ComEd A&G, including the costs incurred for services provided by EBSC and directly incurred through ComEd employees, in order to benchmark and market test those costs. Mr. Flaherty's analysis necessarily <u>does not</u> adjust for ratemaking or *pro forma* adjustments, nor does it functionalize expenses to delivery services. Our testimony includes the adjustments to total A&G costs necessary to develop the revenue requirement. ComEd Ex. 7.4 provides further details on the reconciliation between amounts identified in Mr. Flaherty's testimony and those included in the revenue requirement.

E. <u>Sales and Marketing Expenses</u>

Q. What level of sales and marketing O&M expenses is included in the revenue requirement?

A. No sales and marketing O&M expenses are included in the revenue requirement.

F. <u>Depreciation and Amortization of Electric Utility Plant</u>

Q. What is the appropriate level of depreciation and amortization expenses of electric utility plant included in the revenue requirement?

A. The level of depreciation and amortization expenses assigned and allocated to the revenue requirement is $323,904,000, before adjustments. This amount includes $264,967,000 related to Distribution Plant and $58,937,000 related to General Plant and Intangible Plant. Depreciation and amortization expenses and the annual depreciation rates for Distribution, Transmission and General and Intangible Plant in the 2006 test year are shown on ComEd Ex. 7.1, Schedule C-12. Reflecting *pro forma* adjustments, total depreciation and amortization expenses of $359,027,000 appropriately are included in the revenue requirement. *See* ComEd Ex. 7.1, Schedule C-1.

G. <u>Real Estate Tax Expense</u>

Q. What is the appropriate level of real estate tax expense included in the revenue requirement?

A. The level of real estate tax expense included in the revenue requirement is $17,531,000. Real estate taxes were primarily allocated to the appropriate business function based on estimated functional use of the properties. *See* ComEd Ex. 7.1, Schedule C-19.

H. Taxes Other than Income Taxes

Q. What taxes other than income taxes are appropriately included in the revenue requirement?

A. The level of taxes other than income taxes (including the $17,531,000 of real estate taxes discussed above) included in the revenue requirement is $156,469,000, as shown in ComEd Ex. 7.1, Schedule C-1. Taxes other than income taxes are both assigned and allocated to the revenue requirement as described in ComEd Ex. 7.1, Schedule C-18.

I. Income Taxes

Q. How was the appropriate level of income taxes in the revenue requirement determined?

A. Income taxes have been calculated based on the expenses and miscellaneous revenues assigned or allocated to the distribution function. Because the tax treatment of revenues and expenses is often different from the accounting treatment of those items, ComEd has analyzed 2006 test year book and tax differences and assigned or allocated those differences to the delivery services function as described in ComEd Ex. 7.1, Schedules C-5, C-5.2, and C-5.3. The appropriate amount for income taxes included in the revenue requirement is $219,125,000, which includes *pro forma* adjustments and the impacts of proposed rates. The income tax expense for the revenue requirement is shown in ComEd Ex. 7.1, Schedule C-1.

J. <u>Storm Expense Rider</u>

Q. ComEd also is proposing, as is discussed by Mr. Williams and Mr. Crumrine (ComEd Exs. 4.0 and 11.0, respectively), a storm expense rider. How would the charges or credits under that proposed rider be calculated?

A. ComEd is proposing to set the level of storm restoration expenses in its revenue requirement based on the inflation-adjusted average of those expenses from 2002 through 2007, which is $27,119,000. Beginning in 2009, the proposed storm expense rider will use that baseline level of $27,119,000 of storm expense and provide for calculation of credits or charges based on the difference between the actual level of these expenses incurred in the prior calendar year and the baseline level included in base rates. So, in brief, for example, if the actual amount of storm restoration expenses incurred in the previous calendar year is $20,000,000, then the rider would provide for credits (called Storm Adjustments) in the amount of $7,119,000. Similarly, in brief, if the actual amount of storm expenses incurred in the previous calendar year is $30,000,000, then the rider would provide for charges (also called Storm Adjustments) in the amount of $2,881,000. The rider is discussed in more detail by Mr. Crumrine (ComEd Ex. 11.0).

VI. <u>Miscellaneous Revenues</u>

Q. What miscellaneous revenues are considered in the calculation of the revenue requirement?

A. Miscellaneous revenues recorded in FERC Accounts 450 - 456 in 2006 were $446,155,000 after certain adjustments, but before *pro forma* adjustments discussed previously. *See* ComEd Ex. 7.1, Schedule C-23. Revenues in connection with late payment charges were allocated to the delivery services function based on the ratio of

2006 delivery services at present rates to ComEd's total 2006 revenues. *See* ComEd Ex. 7.2, WPA-5. Revenues received as rental payments for facilities that are recorded in distribution accounts and included in the delivery services rate base have been reflected in full as a reduction to the revenue requirement in this proceeding. These revenues principally relate to meter rentals collected under ComEd's former Rider 7 and optional facilities charges collected under former Rider 6 (tariffs applicable in 2006), and revenues in connection with cable TV pole rentals. Based on a detailed analysis of these revenues, $132,418,000, after adjustments (including *pro forma* adjustments), appropriately was directly assigned or allocated to the delivery services function and was therefore deducted from the revenue requirement. *See* ComEd Ex. 7.1, Schedule C-1. An adjustment of $4,146,000 has been made to reflect annualized revenues to be collected from reselling municipalities as compensation for their usage of a portion of the ComEd distribution system. In prior proceedings ComEd reflected this impact by assigning a portion of each element of the revenue requirement to the reselling municipalities, thereby reducing the revenue requirement. Beginning in June 2007, new FERC jurisdictional tariffs took effect for the municipalities that access the distribution system, and the revenues collected under these tariffs will be used to reduce the revenue requirement. This revenue credit serves the same purpose as the assignment of the individual components of the revenue requirement made in the prior proceeding.

VII. Adjustments, Including *Pro Forma* Adjustments

A. Adjustments to Rate Base

Q. What is the net aggregate amount of all adjustments, including *pro forma* adjustments, to delivery services rate base?

A. The net aggregate amount of all adjustments, including *pro forma* adjustments, is an increase to delivery services rate base of $1,498,317,000. *See* ComEd Ex. 7.1, Schedule B-2.

Q. What is the nature of each of the *pro forma* capital additions adjustments to rate base for purposes of the revenue requirement?

A. ComEd identified additional plant to provide delivery services that has been placed in service in 2007 or is reasonably expected to be placed in service by the end of the third quarter of 2008 and is serving retail customers now or will be serving retail customers before the Commission enters its final Order in this proceeding. The plant projects that comprise these plant additions are identified and quantified in WPB-2.1a and WPB-2.1b, in ComEd Ex. 7.2. This delivery services plant is appropriately included in rate base for purposes of the revenue requirement under numerous prior Commission decisions and 83 Ill. Adm. Code § 287.40. See also ComEd Ex. 7.1, Schedule B-2.1.

In addition, rate base has been adjusted to reflect the expected retirements related to these plant additions. These retirements are shown on ComEd Ex. 7.1, Schedule B-2.1. The net increase to delivery services rate base amount for these *pro forma* adjustments is $1,551,542,000. These *pro forma* adjustments meet the applicable standards for such adjustments. The identification, quantification, and nature of each of these adjustments are addressed in further detail by Messrs. Williams and McMahan (ComEd Exs. 4.0 and 5.0, respectively). That the plant that comprises these adjustments is or will be used and useful and that its costs are or will be prudently and reasonably incurred also is addressed in further detail in that testimony.

In addition, there is a reduction to rate base of $72,001,000 to reflect refunctionalization adjustments. This reduction is the net effect of plant reclassifications from distribution to transmission made on ComEd's books in the third quarter of 2007. The net reduction to rate base for the refunctionalization, including accumulated depreciation and accumulated deferred income tax effects is $60,089,000.

Q. Do the Schedules attached in ComEd Ex. 7.1 carry through the financial impacts of the adjustments to delivery services rate base?

A. Yes. The schedules reflect adjustments, such as accumulated depreciation and accumulated deferred income taxes related to these adjustments, to the delivery services rate base.

B. <u>Adjustments to Operating Revenue and Expenses</u>

Q. What is the quantification and nature of each of the adjustments to delivery services operating expenses that are related to the two rate base adjustments described in Section VII(A), above?

A. The net impact on delivery service operating expenses for the two rate base adjustments described in Section VII(A) is an aggregate increase to operating expenses before income taxes of $36,879,000. ComEd Ex. 7.1, Schedule C-2, identifies the net impact for each of these adjustments. These adjustments are identified as ComEd Ex. 7.1, Schedules C-2.7, C-2.12, and C-2.16.

(1) ComEd Ex. 7.1, Schedule C-2.7, adds $45,791,000, before income taxes, to delivery services operating expenses for additional depreciation and amortization expenses related to the *pro forma* plant additions.

(2) ComEd Ex. 7.1, Schedule C-2.12, reduces delivery services depreciation expenses by $9,102,000 before income taxes, to reflect the expected retirements related to the *pro forma* plant additions.

(3) ComEd Ex. 7.1, Schedule C-2.16, adds $190,000 to delivery services operating expenses for uncollectible expenses associated with *pro forma* capital additions that are "new business."

Q. Were there rate base-related adjustments to other operating income items not described above?

A. Yes. Along with adjustments to operating expense as described above, the rate base adjustments also have the following impacts on miscellaneous revenues and income taxes:

(1) As approved by the Commission in Docket No. 05-0597, ComEd has included a revenue credit (which reduces the revenue requirement) of $26,401,000 to reflect the anticipated increase in revenue over the test year associated with the *pro forma* capital additions that are "new business." *See* ComEd Ex. 7.1, Schedule C-2.16.

(2) The income tax impact of the adjustments to operating expenses and operating revenues above is a reduction to the revenue requirement of $26,201,000. *See* ComEd Ex. 7.1, Schedule C-2, page 1, column (H), line 23; *id*., page 2, column (G), line 23, page 3, columns (D) and (H), line 23.

Q. Please describe in more detail the ratemaking adjustments to operating expense.

A. ComEd Ex. 7.2, WPC-1a, identifies the various ratemaking adjustments to 2006 operating expenses. These ratemaking adjustments include: (1) the removal of O&M

costs for which ComEd is not seeking recovery, including costs incurred in 2006 associated with CARE, certain expenses related to ComEd's Residential Rate Stabilization Program and Sustainable Energy Plan, general advertising expenses and certain executive compensation costs; (2) charitable contributions that are recorded below the line in Account 426 but have traditionally been recoverable through rates; (3) the removal of costs that are recoverable outside of the delivery services tariff, such as MGP costs recoverable through Rider ECR, or costs recoverable through the Supply Administration Charge; (4) the removal of costs that have been directly assigned to the transmission function; and (5) the removal of one-time accounting credits related to the establishment of regulatory assets for severance costs and MGP costs as a result of the ICC's Order in Docket No. 05-0597.

Q. Please describe in more detail the nature of the *pro forma* adjustments to operating expenses.

A. The following *pro forma* adjustments to test year operating expense have been made to reflect changes to 2006 historical cost levels that are known and measurable and expected:

(1) ComEd Ex. 7.1, Schedule C-2.1, reflects the adjustment made to delivery services operating expenses to reflect the 2007 general pay increases to ComEd employees. This adjustment is consistent with prior ICC decisions, and is known and measurable. The increase to operating expenses for this adjustment is $7,082,000, before income taxes.

(2) ComEd Ex. 7.1, Schedule C-2.2, reduces delivery services operating expenses by $11,424,000 before income taxes, by replacing actual 2006 O&M expenses for

storm restoration activities of $38,543,000 with a six-year (2002-2007) average of $27,119,000. This six-year average is also $27,718,000 lower than the storm restoration O&M expenses for 2007 of $54,837,000 (based on actual costs for the first eight months and a projection for the rest of the year). The adjustment is consistent with the Commission's Order in Docket No. 05-0597. ComEd also is proposing, as is discussed by Mr. Williams and Mr. Crumrine (ComEd Exs. 4.0 and 11.0, respectively), a storm repair expense rider, which we discuss in Section V(J), below.

(3) ComEd Ex. 7.1, Schedule C-2.3, reduces delivery services operating expenses by $5,281,000, before income taxes, to remove incremental costs incurred by ComEd in 2006 in connection with the proposed merger of Exelon Corporation with Public Service Enterprise Group.

(4) ComEd Ex. 7.1, Schedule C-2.4, reduces delivery services operating expenses by $1,576,000, before income taxes, to reflect lower amortization of customer billing software costs following the transfer of a portion of those costs to its affiliate PECO Energy Company ("PECO"). In November 2006, PECO implemented the CIMS customer system, and will share some of the system with ComEd, resulting in lower costs to ComEd. The adjustment is necessary to recognize a full year's effect of these lower costs.

(5) ComEd Ex. 7.1, Schedule C-2.5, increases delivery services operating expenses by $932,000, before income taxes, to reflect higher annual postal costs incurred to mail bills and credit notices as a result of the increase in U.S. postage rates that became effective on May 14, 2007.

(6) ComEd Ex. 7.1, Schedule C-2.6, increases delivery services operating expenses by $3,385,000, before income taxes, to replace the actual 2006 incentive compensation expense (which was below target levels) with the 2007 target incentive compensation expense for ComEd employees. As more fully described by Mr. McDonald (ComEd Ex. 9.0), ComEd changed the metrics upon which its 2007 incentive compensation program is based, and as a result, none of this compensation expense is determined by earnings per share funding measures.

(7) ComEd Ex. 7.1, Schedule C-2.8, increases delivery services expenses by $14,877,000, before income taxes, to reflect the increase in ComEd's pension and retiree health care expense reflected in the latest actuarial report. In May 2007, outside consultants Towers Perrin issued an updated actuarial analysis which indicates that ComEd's pension and retiree health care expenses in 2007 will be $7,373,000 and $7,504,000, respectively, higher than in 2006. (*See* ComEd Ex. 7.2, WPC-2.8). This adjustment is consistent with the Commission's past practice, which typically has been to reflect the most recent actuarial analysis in the determination of the appropriate amount of pension and retiree health care expense to include in the test year revenue requirement.

(8) ComEd Ex. 7.1, Schedule C-2.9, increases delivery services operating expenses by $3,833,000, before income taxes, to recover estimated rate case expenses in connection with this proceeding. Consistent with the recovery of rate case expenses in ComEd's last rate proceeding, ComEd proposes to amortize the estimated costs for this proceeding over a three-year period.

(9) ComEd Ex. 7.1, Schedule C-2.10, adjusts the 2006 delivery services operating expenses to reflect $190,000 of incurred and estimated costs in connection with the Original Cost Audit initiated by the Commission in Docket No. 05-0597. ComEd proposes to amortize and recover the total costs of the audit over a three-year period, consistent with the recovery of rate case expenses provided for in that Docket.

(10) ComEd Ex. 7.1, Schedule C-2.11, reduces delivery services operating expenses by $244,000, before income taxes, to reflect the phase-out of certain executive benefits effective January 1, 2008.

(11) ComEd Ex. 7.1, Schedule C-2.14, increases 2006 delivery service operating expenses by $726,000 to reflect one year's amortization of additional actual rate case expenses incurred in 2006 related to the rehearing in ICC Docket No. 05-0597, which were not requested or authorized for recovery in that docket. ComEd is proposing that the additional costs be amortized over a three-year period similar to other rate case expenses incurred for Docket No. 05-0597.

(12) ComEd Ex. 7.1, Schedule C-2.15, adjusts 2006 delivery services operating expense to remove actual rate case expenses incurred in 2006 related to ICC Docket No. 05-0597 and to reflect one year's amortization of the amount authorized for recovery by the Commission's Order in that Docket. Additionally, ComEd is requesting recovery of $1,048,000 of incremental expenses incurred in connection with that proceeding, above the amount authorized for recovery in that Docket. ComEd proposes to amortize these additional costs over a three-year

period, consistent with the amortization period for the amount previously authorized for recovery.

(13) ComEd Ex. 7.1, Schedule C-2.17, increases delivery services expenses by $1,690,000, before income taxes, to reflect the proposed recovery of annual expenditures for the removal of PCB contaminated oil from transformers. In 2005, pursuant to new accounting guidelines, ComEd recorded a liability of $14,933,000 related to its plans to replace PCB contaminated oil in the period 2006-2012. Prior to 2005, these expenditures were recorded as O&M expense. This adjustment simply provides for recovery of the annual PCB clean up costs consistent with years prior to 2005.

(14) ComEd Ex. 7.1, Schedule C-2.18, increases delivery service operating expenses by $25,387,000, before income taxes, to reflect a debt return on ComEd's shareholder funded 2005 pension contribution. The debt return was calculated using a debt rate of 4.75% consistent with the Order on Rehearing in ICC Docket No. 05-0597.

(15) ComEd Ex. 7.1, Schedule C-2.19, decreases delivery service depreciation expense by $1,680,000, before income taxes, to reflect the refunctionalization of plant from distribution to transmission in 2007 as described earlier in our testimony.

Q. What is the revenue requirement impact of any significant organizational changes that have occurred since the test year?

A. During 2006, ComEd obtained certain engineering, project management, customer support, and other support services from Energy Delivery Shared Services (“EDSS”). During 2007, it was determined that these functions could be performed directly by

ComEd employees to further improve line of sight with senior management and without losing the efficiencies gained from the previous organizational structure. This reorganization results in a transfer of employees from EDSS to ComEd beginning in 2007. The overall effect of the reorganization is expected to be cost neutral to ComEd, *i.e.*, the reduction in EDSS charges to ComEd will be offset by increases in internally incurred costs for these functions. There are no anticipated incremental costs or cost savings as a result of the change in organizational design; therefore, no *pro forma* adjustments are necessary or appropriate.

Q. Do the Schedules attached in ComEd Ex. 7.1 carry through the financial impacts of each of the adjustments to delivery services operating expenses for purposes of the revenue requirement?

A. Yes. The net delivery services operating expenses amount of each adjustment reflects the related adjustments to income taxes and, if applicable, other delivery services expenses.

C. Adjustments, Including *Pro Forma* Adjustments, to Miscellaneous Revenues

Q. Are there any *pro forma* adjustments to miscellaneous revenues?

A. Yes. In addition to the $26,401,000 reduction to the revenue requirement for revenues associated with the new business related plant additions, we have reduced the revenue requirement to reflect increased revenues of $2,921,000 associated with the implementation of new tariff charges for late payment fees and reconnection charges that became effective January 2, 2007, and proposed changes to Rider ZSS – Zero Standard Service 2007, Rider ML-Meter Leases, and other General Terms & Conditions. *See* ComEd Ex. 7.1, Schedule C-2.13.

VIII. <u>Gross Revenue Conversion Factor</u>

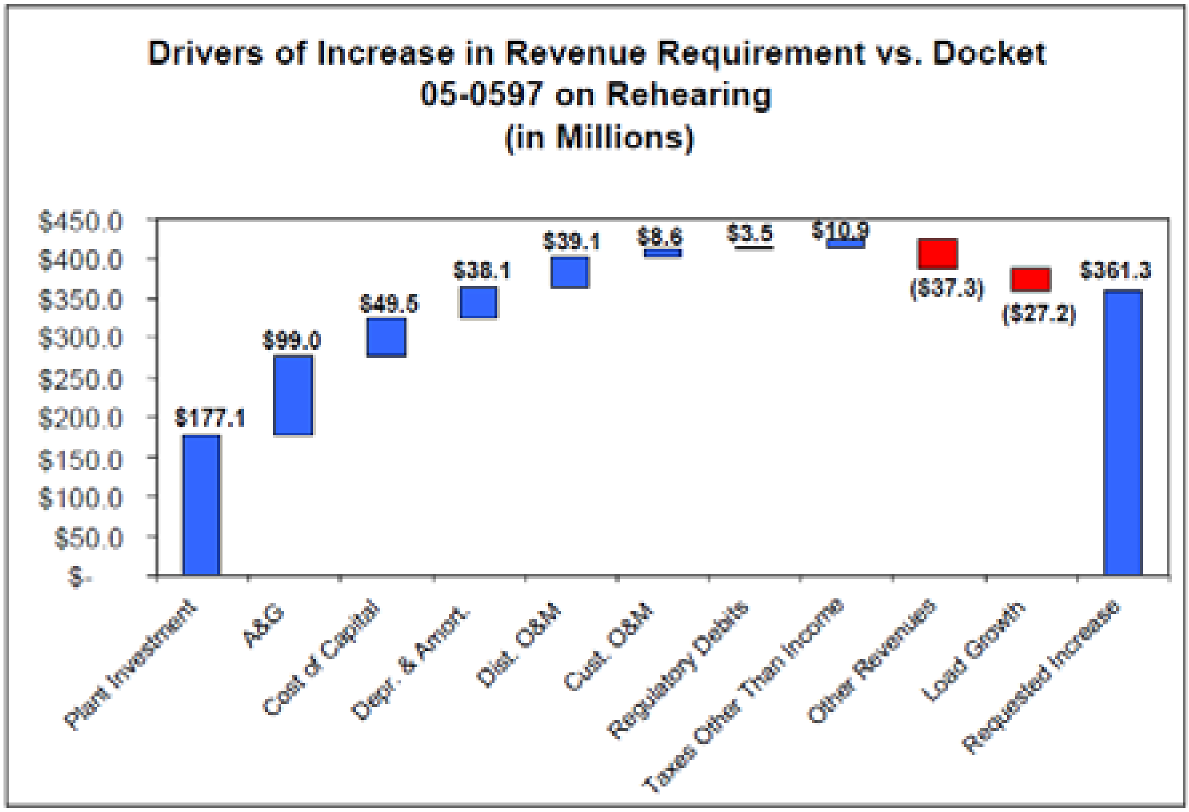
Q. What is ComEd's Gross Revenue Conversion Factor?

A. The Gross Revenue Conversion Factor, excluding incremental uncollectible expense and add-on revenue taxes, to be used in determining the revenue requirement, is 1.660. Including incremental uncollectible expense, the Gross Revenue Conversion Factor is 1.672.

IX. Comparison of ComEd Revenue Requirement <u>to 2005 Rate Case Order on Rehearing</u>

Q. Previously in the testimony you discussed the change in the revenue requirement as compared to the revenue requirement allowed in the ICC Docket No. 05-0597 Order on Rehearing. Can you provide additional detail regarding the primary drivers of the increase?

A. Yes – The primary drivers of the increase in the revenue requirement are discussed below:



Increased Rate Base - investment in Plant - $177.1 million: About half of the increase is attributable to increased investment in net rate base assets, the vast majority of which is increased investment in distribution plant assets as more fully described by Messrs. Williams and McMahan (ComEd Exs. 4.0 and 5.0, respectively).

Higher cost of capital - $49.5 million: The overall cost of capital in this proceeding is 8.55%, compared to an overall cost of capital of 8.01% approved in ICC Docket No. 05-0597. The increase in the cost of capital primarily reflects a higher return on equity (10.75% compared to 10.045% allowed in ICC Docket No. 05-0597) and a slightly higher common equity ratio (45.11% vs. 42.86%). *See* the Direct Testimony of Mr. McDonald (ComEd Ex. 9.0) and Mr. Hadaway (ComEd Ex. 10.0)

Higher depreciation expense - $38.1 million: Depreciation expense increased as a result of the substantial investment, including *pro forma* adjustments, in depreciable plant assets.

Higher Operating Expenses - $161.1 million: Operating expenses, including *pro forma* adjustments, are higher than the amount allowed in the last rate proceeding due to the following:

- Administrative and General expenses have increased by $99 million above the amount approved for recovery in ICC Docket No. 05-0597. Of this amount, $19.8 million is due to an accounting reclassification of rental revenue credits that increased A&G expense. The reclassification moved these revenues to Other Revenue (miscellaneous revenues) and thus did not result in an increase to the revenue requirement. The components of the A&G cost increases are discussed in more detail later in our testimony.

- Customer and Distribution O&M expenses have increased by $47.7 million above the amount reflected in the last rate case's Order on Rehearing primarily reflecting higher wages and incentive costs, and higher overhead and underground line maintenance costs, as described further by Mr. Williams (ComEd Ex. 4.0).

- Other operating expenses have increased by $14.4 million, including higher taxes other than income taxes ($10.9 million) and higher rate case and regulatory costs ($3.5 million).

Higher Revenues and Load Growth – ($64.5 million). Revenue partially increased due to the reclassification of rental revenues, as described earlier, which along with other increases, reduces the revenue requirement by $37.3 million. Additionally, load growth since 2004 increases the billing determinants used to calculate the charges, which reduces the revenue requirement increase by $27.2 million.

Q. What factors led to an increase in Administrative and General expenses above the amount allowed for recovery in the ICC Docket No. 05-0597 Order on Rehearing?

A. A&G expenses encompass a wide variety of activities that support the operating functions of ComEd. The increase in A&G expenses over the last rate case Order on Rehearing is attributable to the factors described below. The level of A&G expenses approved by the Commission in the last case and the amount requested in this case are detailed in ComEd Ex. 7.3.

Increase in Jurisdictional A&G Costs vs. 05-0597 Order	(in millions)
Reclassification of Rental Revenues	$19.8
Pension	$21.0
Post-retirement Health Care	$10.7
Medical & Other Benefits	($5.2)
Business Service Company	$33.7
Vacation Accrual	$3.0
FERC Credit Reversal	$3.3
Charitable Contributions	$2.8
Rent Expense	$2.8
Inventory Obsolescence Reserve	$2.3
Settlement of Litigation	($3.2)
Other	$7.9
Total	$99.0

Reclassification of rental revenues - $19.8 million. ComEd pays rental expense on certain properties that are subleased to affiliates. In the 2004 test year, the revenue that ComEd received from affiliates for the subleases was recorded on a net basis, *i.e.*, the revenue received from affiliates was recorded in the same A&G accounts that the underlying rent expense paid by ComEd was recorded in. Beginning in 2006, the revenue that ComEd receives from affiliates related to these subleases is recorded separately (in revenue accounts) from the rental expense A&G accounts. This effect of this accounting reclassification increases test year A&G expense by $19.8 million compared to the 2004 test year, but has no impact on the overall revenue requirement because the increase in expense is entirely offset by an increase in Other Revenue (Account 454 – Rent from Electric Property).

Pension Expense - $21.0 million. The 2006 test year reflects jurisdictional pension expense of $22.6 million compared to $1.6 million allowed in the ICC Docket No. 05-0597 Order on Rehearing. This increase is based on the May 2007 Towers Perrin actuarial report, which forecasted higher pension expenses for 2007 versus ComEd's 2005 pension expense which was included in ComEd's last approved revenue requirement. The increase is in large part due to externally-driven market factors that are not unique to ComEd, including the use of updated mortality statistics mandated by the Department of Treasury, along with a decrease in expected returns on plan assets and actuarial and demographic losses. The 2007 pension expense reflects the annual benefit of the $803 million pension contribution that was made in 2005; and as a result 2007 pension expense is lower that it would have been had the pension contribution not been made.

Post-Retirement Health Care Costs - $10.7 million. The 2006 test year includes $30.0 million for retiree health care costs compared to $19.3 million allowed in the ICC Docket No. 05-0597 Order on Rehearing. Similar to pension expense, the test year amount is based upon the May 2007 actuarial report, and much of the increase results from externally-driven market factors that include updated mortality statistics, actuarial and demographic losses, and increases in medical cost rates.

Medical and Other Employee Benefit Costs – ($5.2 million). Medical and other employee benefit costs are lower than in 2004 as a result of Exelon-specific health and wellness programs for active employees as well as cost containment efforts such as increasing employee contributions to health care costs.

Business Services Company Costs - $33.7 million. Costs from EBSC increased jurisdictional A&G expenses, primarily reflecting higher costs for Information Technology ($10.6 million) and Energy Delivery Shared Services ($4.3 million). Additionally, higher Executive Service charges ($6.7 million), higher Finance costs ($7.4 million) along with changes in other practice areas drove the increase. The increase in Information Technology costs is due largely to a change in the accounting for desktop and mainframe computer costs that reclassified the costs from Customer and Distribution Accounts to A&G. ComEd is requesting recovery of 100% of its 2006 Sarbanes-Oxley costs, as these costs are legally mandated and ComEd has no choice but to comply with the laws giving rise to these costs (similar to income taxes and environmental remediation). Recovery of 100% of ComEd's Sarbanes-Oxley costs as requested in the previous case is pending appeal. In this proceeding, ComEd is seeking recovery of approximately $0.3 million less than the $3.9 million of Sarbanes-Oxley costs allowed in the ICC Docket No. 05-0597 Order on Rehearing.

Vacation Accrual - $3.0 million. ComEd's vacation accrual increased jurisdictional A&G expense by $3.0 million compared to the amount allowed based on the 2004 test year in ICC Docket No. 05-0597. The 2004 test year amount included a net "one-time" credit resulting from a significant reduction in employees from 2003 to 2004 due to Exelon Way. The absence of the credit in 2006 increased A&G expenses relative to 2004. There were no significant changes in vacation policies between 2004 and 2006.

FERC credit - $3.3 million. The 2004 test year included a credit of $3.3 million relating to fees that were accrued in 2003 but reversed in 2004 upon ComEd's joining the PJM Interconnection, L.L.C. The absence of the credit (the reversal) in 2006 increased A&G expenses relative to 2004.

Charitable contributions – $2.8 million. Contributions of $6.1 million in the 2006 test year are higher than the $3.3 million in the 2004 test year. The increase in charitable contributions was a result of a review conducted in 2005 which concluded that ComEd's charitable contributions were lower than U.S. and utility averages, and that it would be appropriate to increase the level of giving in order to bring ComEd more in line with other utilities. ComEd Ex. 7.1, Schedule C-7, provides a listing of all 2006 charitable contributions of $5,000 and greater.

Rent Expense - $2.8 million. Rental expense for office facilities increased, largely related to increase in rentals for the west suburban Lincoln Center office facilities.

Inventory Obsolescence Reserve - $2.3 million. The increase in this expense is primarily due to a change in accounting for proceeds from the sale of obsolete materials. In 2004, approximately $2 million of scrap wire and cable recoveries were recorded as credits to Account 930.2 which reduced the provisions for inventory obsolescence. Beginning in 2006, these recoveries are recorded primarily in Account 108, Accumulated Reserve for Depreciation. The absence of the credits increases A&G expense in 2006 relative to 2004. The remaining $0.6 million increase is due to adjustments of the obsolete materials reserve made in the normal course of business.

Settlement of Litigation - ($3.2 million). The 2004 test year included a $3.2 million reserve for employee-related claims filed in connection with employee terminations in 2004. The 2006 test year does not include employee litigation costs.

Other – $7.9 million. A variety of smaller items, none of which are individually significant, collectively increased A&G expense by $7.9 million. *See* ComEd Ex. 7.3, page 4.

Q. Does that conclude your direct testimony?

A. Yes.