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company and Administrative & General (“A&G”)¹ costs, in ComEd’s goodwill-free capital structure, in ComEd’s treatment of its pension asset, in the detailed data supporting its *pro forma* capital additions, and in the changes to ComEd’s incentive compensation program made in response to the Commission’s Order in ComEd’s last rate case.² In contrast, several significant proposed disallowances run directly counter to past Commission decisions or unlawfully rely on demands for data not imposed on other utilities by the Commission’s rules or past decisions. The two most egregious examples are (1) IIEC’s and AG/CUB’s effort to increase ComEd’s depreciation reserve and accumulated deferred income tax (“ADIT”) balances for test year plant through the date of the *pro forma* plant additions, and (2) Staff’s proposed disallowance of \$111 million of actual investment in underground cable and services. These two “adjustments” would reduce ComEd’s ability to recover its costs by at least \$104 million annually (and potentially more depending upon how issues such as return on equity are resolved). The latter adjustment alone would require ComEd to take a substantial write-off that would decrease ComEd’s 2008 earnings by more than \$60 million. These adjustments, if adopted, would also be inexplicable departures from other recent Commission rulings and would arbitrarily and capriciously change the rules on ComEd.

The Commission emphasized in the recent *Peoples Gas* Order³ that:

All parties should agree that Commission action brings certainty to a situation and settles expectations. This is another way of saying that unless there are clear and distinguishable reasons for deciding a case differently, the Commission will follow in line with precedent. To do otherwise risks a charge of arbitrary and capricious action.

¹ Common abbreviations already defined in ComEd’s Initial Brief (“Init. Br.”) have the same meaning here.

² *Commonwealth Edison Co*, ICC Docket No. 05-0597 (Order, July 26, 2006; Order on Rehearing, Dec. 20, 2006).

³ *North Shore Gas Co., et al.*, ICC Docket Nos. 07-0241/07-0242 Cons. (Order, Feb. 5, 2008) (hereinafter cited as “*Peoples Gas*” and referred to as the “*Peoples Gas* Order”).

Peoples Gas Order at 16 (emphasis added). Were the Commission to deny ComEd recovery of more than \$111 million of actual delivery assets based on standards that are inconsistent with past decisions and that could not be anticipated, it would send a strong and destructive signal to the financial community both about ComEd's prospects and the consistency and fairness of Illinois ratemaking.

A. ComEd's Revenue Requirement

Other parties said little about ComEd's revenue requirement that touched on the key points made in ComEd's opening brief. As ComEd's Initial Brief (at 10-11) describes, a utility is entitled to a revenue requirement that includes all reasonable and prudently incurred expenses and is entitled to include in its rate base all reasonable and prudently incurred costs of assets that are used and useful in providing utility service. *E.g.*, 220 ILCS 5/9-211, 16-108(c); *Commonwealth Edison Co.*, Docket No. 94-0065, 1995 Ill. PUC Lexis 25, *5 (Order Jan, 9, 1995), *aff'd in part and rev'd in part on other grounds*, 291 Ill. App. 3d 300 (1st Dist. 1997). ComEd's proposed revenue requirement is based almost completely on undisputed evidence quantifying ComEd's plant additions and ComEd's increased operating expenses. No evidence proved that any rate base asset could have been acquired at a lower cost or was placed in service imprudently or needlessly.

In contrast, the AG/CUB lowball revenue recommendation is based largely on (1) using an unsupported, unaccepted, and flawed methodology to lower ComEd's allowed ROE to unprecedented levels well below those of all other Illinois utilities and well below those of ComEd's competitors for capital; and (2) adopting positions on ComEd's depreciation reserve, ADIT balance, and *pro forma* capital additions wholly at odds with prior Commission orders, the Commission's rules, and the evidence. IIEC, while also advocating sizeable disallowances,

seems to think that so long as the Commission allows ComEd IIEC's preferred 10.2% ROE, ComEd can regain an investment grade rating. IIEC Init. Br. at 39-41. That is naïve, wishful thinking. Mr. Gorman calculated the credit metrics incorrectly, ignored that rating agencies will look at cash flows in the year after new rates go into effect, and incorrectly presumed that ComEd's risky profile was entirely due to doubts over recovering commodity costs. McDonald Reb., ComEd Ex. 28.0, 5:88 – 6:117, 7:150 – 8:172. Moreover, without recognition of the substantial increase in ComEd's rate base and operating expenses, and the increased cash flows required to support them, ComEd will continue to suffer great financial distress. To have any hope of climbing back from its "junk" ratings, ComEd must have improved cash flows to recover its costs. Abbott Sur., ComEd Ex. 35.0, 3:56-4:79. That can happen only if substantial rate relief is given in this case.

Only five major revenue requirement issues remain:

1. ComEd/Staff Stipulation. The AG claims the Stipulation cannot be approved by the Commission. As shown in Section IV.B.1.e, *infra*, the AG's position is incorrect and reflects a fundamental misunderstanding of the Stipulation. The Stipulation urges that the Commission decide issues in accordance with evidence in the record and, in particular, both ComEd and Staff testimony. It is not a settlement. Approving agreed recommendations that are supported by evidence is completely lawful. It is also lawful for ComEd to conditionally waive portions of its own proven rate increase request, and the legality of ComEd doing so does not require "evidence."

2. Depreciation Reserve / ADIT. ComEd quantified its depreciation reserve and related ADIT strictly in accordance with applicable Commission rules and decisions, including the past two ComEd rate cases and the recent *Peoples Gas* Order. As shown in Section IV.C.2,

infra, efforts by a few intervenors to dodge those rules and distinguish those unequivocal decisions are specious and are not supported by Staff. IIEC’s request that the Commission “disavow” its prior decisions at least frankly acknowledges the inconsistency of its position with prior decisions, but its request is unfounded. ComEd’s depreciation reserve and ADIT balance should be approved.

3. Underground Cable and Services Assets. ComEd proved that these rate base assets are used and useful and were acquired prudently, through appropriate processes, and at reasonable cost. Mr. Lazare proposes disallowing \$111 million of these delivery assets on the notion that this portion of their cost is “unexplained.” As shown in Section IV.B.1.b, *infra*, there are no mystery costs to explain. Mr. Lazare errs at every step, misusing data and employing meaningless math. He demands that ComEd produce data about these assets in a way foreign to the Uniform System of Accounts (“USOA”), and not required by any Commission rule or previous order. He unfairly and inaccurately labels costs as “unexplained” because ComEd provided cost data in accordance with Commission rules, rather than as Mr. Lazare unilaterally demands. Ultimately, he seeks to penalize ComEd with an unlawful and unprecedented retroactive disallowance because ComEd complied with those Commission rules rather than anticipating his novel demand. At the same time, his analysis admittedly ignores volumes of relevant data about cable and service costs, including analyses and detailed records of the costs of the actual projects where these assets were installed.

4. Incentive Compensation. ComEd restructured its incentive compensation to conform to the Commission’s decision in ComEd’s last rate case. As shown in Section IV.C.1, *infra*, the vast majority of ComEd’s incentive compensation costs are expressly allowed under the Commission’s decisions. There is no sound basis to even consider disallowance.

5. Return on Equity. As shown in Section VI.C, *infra*, ComEd proved that a 10.75% ROE was appropriate. Staff differed with ComEd, largely on methodological grounds. However, the cost of capital has increased during this case, and even Staff's methodology results in a 10.65% ROE for ComEd if the data is updated to use the same sample date that Staff used in the pending Ameren cases. Hadaway Sur., ComEd Ex. 42.0, 5:58-68. While Ameren and ComEd are certainly different companies with different costs, there is no reason that ComEd's ROE should be well below Ameren's solely because Staff chose a different sample date for ComEd that it did not then update despite increasing capital costs. The evidence also shows that IIEC's 10.2% ROE and CUB's 7.77% ROE should be rejected. They are low – in CUB's case unprecedented – and suffer from inferior data and methodology.

B. Rider SMP and Rider SEA

Many parties, including both customer representatives and competitive suppliers, support approval of Rider SMP in this case. They recognize the benefits to customers and the importance to the State economy of being a leader in Smart Grid deployment. Approving Rider SMP now is an essential first step toward delivering those benefits. Rider SMP not only establishes the structure through which potential Smart Grid technologies are analyzed, but provides the essential regulatory certainty and cost recovery mechanism that must precede any serious exploration of Smart Grid technologies.

The opposing arguments span the spectrum, but as shown in Section VII.C, *infra*, all are without merit. First, some opponents claim that the definition of potential System Modernization Projects ("SMPs") is too broad and that inappropriate projects may qualify. ComEd addressed this objection, including by agreeing to accept the Staff definition of Smart Grid projects. But, more fundamentally, this objection ignores that no project can commence and not one dollar can

be recovered from any customer, unless the Commission has already concluded that the particular project is beneficial and should proceed. At its core, arguing for a narrow definition is arguing to limit the Commission's ability to decide what projects should proceed.

Some objectors also oppose Rider SMP because they want yet more "process" beyond the extensive discussion in this rate case, the periodic stakeholder workshops, and the subsequent formal Commission proceeding established by the Rider. In part, they are uneasy that Smart Grid technology is new and evolving. In fact, Smart Grid technologies will continue to evolve for the foreseeable future. Projects that remain too uncertain after the workshops will not be proposed by ComEd or approved by the Commission. Also, while technologies are developing, the benefits of Smart Grid technologies are already clear to policymakers. Waiting until those technologies are no longer evolving, or worse, trying to nail them down in legal rules defining service obligations, would be counterproductive. Illinois would be left years behind. The desire to postpone action also ignores that some technologies (*e.g.*, AMI) already have well understood options and are the foundation of future development. Work must begin promptly on evaluating those projects if the Smart Grid in Illinois is not to lag further.

Regulatory certainty is an essential precondition to deploying even initial, foundational Smart Grid technologies such as AMI. Especially given that some parties question the value of Smart Grid projects, ComEd cannot make these large investments subject to an after-the-fact review in a future rate case, nor under a process where the basic features of the Rider itself are left undetermined. ComEd cannot, for example, consider replacing meters with remaining useful life without firm advance approval rendered through a process on which parties can rely. Not acting to establish a firm process in this case, and deferring these issues to other proceedings or workshops, will leave ComEd unable to obtain or commit the significant investments required.

It will deprive Illinois customers of the benefits of system modernization projects the Commission would find to be worthwhile.

Rider SMP is also plainly within the Commission's authority to approve. In the comprehensive analysis in *Peoples Gas*, the Commission expressly concluded that it has the authority to approve infrastructure riders. *Peoples Gas* Order at 152. Objections that cling to the language in *Finkl*⁴ as if it still sets out (and, actually, it never did) a standard that all riders – no matter what their type or purpose – must meet, misstate the law and ignore appellate decisions that state otherwise. Rider SMP and the process it envisions are, moreover, fully consistent with the federal Energy Independence Security Act of 2007 (“EISA”) and the actions it calls upon states to undertake. The Commission should take this opportunity to approve Rider SMP and thereby take a meaningful step towards bringing to Illinois customers the advantages Smart Grid offers.

Very little has been said about ComEd's proposed storm expense adjustment rider, Rider SEA, that ComEd has not already addressed in its Initial Brief. Although IIEC claims that Rider SEA will “shift risk” from ComEd to customers, that is not true. The only risk being eliminated is that ComEd will over or under recover its storm restoration costs. Likewise, Staff's claim that ComEd failed to present evidence of the Rider's likely “success” or “failure” in addressing storm risk, fails to recognize that Rider SEA is guaranteed to succeed in accomplishing the principal goal of ratemaking – allowing recovery of prudently-incurred costs, no more and no less. Rider SEA should be approved with the modifications accepted by ComEd and referenced in its Initial Brief.

⁴ A. *Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill App. 3d 317 (1st Dist. 1993) (“*Finkl*”).

C. Cost of Service/Rate Design

The primary issue on revenue allocation and rate design is whether the Commission ought to rely upon ComEd's embedded cost of service study ("ECOSS"), or whether the allocation and design should incorporate other principles, including an admitted departure from the cost-causation principle. Those who are most emphatic in their criticisms of the ECOSS are also those who have the most to gain by not having revenues allocated according to cost. The two parties who have nothing to gain financially from reliance on that study – ComEd and Staff – both find the study acceptable as a basis for revenue allocation and rate design. Even REACT, which embraces the notion that "costs should be allocated to actual cost causers" (REACT Init. Br. at 21), on this issue ironically yields to its self-interest in continuing existing subsidies. However, rate design should not devolve into disputes between different groups of customers arguing for their opposing parochial financial interests. ComEd urges that the Commission again use cost of service, consistent with past decisions, as a guide for allocation and rate design, subject only to the possible temporary mitigation of moving the largest customers only half way to full cost recovery at this time. If steps are not taken now to remedy the subsidies that are embedded in ComEd's rates, it will become increasingly difficult for the Commission in the future to achieve any semblance of matching rates with costs and sending proper price signals to customers.

II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY

ComEd’s full revenue deficiency is \$345.404 million, as discussed in Sections I and II of ComEd’s Initial Brief. Under the joint recommendations made in the Staff/ComEd Stipulation, ComEd offers the limited concession in this case of not seeking to recover \$30.953 million of that revenue deficiency, which would yield a rate increase of \$314.451 million. Only Staff’s and the AG’s Initial Briefs address (other than in passing) ComEd’s revenue deficiency as such.

Staff. Staff claims that ComEd’s revenue deficiency is \$262.042 million. *See* Staff Init. Br. at 3 and Appendix A, p. 1.⁵ Of the \$52.409 million difference between ComEd’s and Staff’s figures, \$51.091 million rests on three proposals, as shown in the following chart:

Staff Proposal	Revenue Impact
Staff’s proposed rate of return on common equity (ROE) of 10.30%	\$22.714 million
Mr. Lazare’s unsupported and incorrect proposal to disallow \$110.954 million of underground lines and services gross plant (\$104.600 million of net plant) in rate base	\$14.697 million*
Staff’s proposal to disallow more than half of ComEd’s incentive compensation costs and expenses, including half of the amounts paid under ComEd’s Annual Incentive Plan’s “Total Cost” goal for which the Commission expressly approved cost recovery in ComEd’s 2005 rate case	\$13.680 million (\$6.154 million on Total Cost goal)*
Total	\$51.091 million
*Figures use Staff’s proposed rate of return on rate base	

Those three Staff proposals are without merit, as shown in Sections IV.C.1.b, V.C.1, and VI.C, respectively, of ComEd’s Initial Brief and this Reply Brief.

⁵ Staff’s rebuttal testimony supported a revenue deficiency of \$269.136 million. Hathhorn Reb., Staff Ex. 14.0, Sched. 14.1, line 26. Staff, in its Initial Brief, reflected a further reduction of \$7.094 million based on the three downward adjustments to rate base that ComEd made in its surrebuttal. Staff Init. Br., Appendix A (see page 1, line 24, page 5, column (h), and page 6, columns (k) and (l)). Thus, the actual difference between ComEd and Staff is \$52.409 million (314.451- 262.042).

The AG. The AG asserts that ComEd faces a revised revenue deficiency of \$44.402 million. *See* AG Init. Br. at 2.⁶ Approximately half of the difference between ComEd’s actual revenue deficiency and the AG’s claim is due to the AG’s use of CUB’s unrealistically low proposed ROE of 7.77%. Most of the remaining difference of \$91,946,000,⁷ is due to the AG proposal (which CUB joins) to reduce ComEd’s rate base by adding post-test year depreciation expenses and deferred income taxes related to test year plant to the Depreciation Reserve and the ADIT balance. This proposed rate base reduction is contrary to the Commission’s test year and *pro forma* adjustments rules and contrary to express rulings in all three of the Commission Orders deciding the same issue in the past. The AG’s and CUB’s positions on each of those issues are without merit as shown in Sections VI.C, IV.C.2, and IV.C.3 of both ComEd’s Initial Brief and this Reply Brief.

III. TEST YEAR

No party challenges use of the 2006 historical test year.

⁶ The AG’s Initial Brief on page 2 is replete with misstated figures. First, the AG’s brief states that ComEd’s rate increase should be no more than \$43.9 million, rounded down from \$43.993 million, but in the next paragraph it says that the AG has recalculated the “revenue requirement”, apparently meaning the revenue deficiency, as \$44.201 million. Second, the AG’s brief refers to ComEd’s proposed revenue requirement as \$601,350,000, but that is ComEd’s rebuttal figure for its jurisdictional operating income, not its revenue requirement. ComEd Ex. 25.01, Sched. C-1, page 1, line 24, column (I). Third, the AG’s brief says that ComEd’s figure for its revenue deficiency is \$355,402,000, but the correct figure is \$345,404,000. ComEd Init. Br. at 11. Finally, the AG’s brief says that its figure of \$44.201 million is “\$257,149,000 less than what the Company proposes”, but the \$257,149,000 figure does not tie to any other figure in the paragraph. \$44.201 million is \$557,149,000 less than ComEd’s rebuttal jurisdictional operating income figure of \$601,350,000, but that is a meaningless comparison.

⁷ The figure of \$91,946,000 uses ComEd’s proposed rate of return. The figure is \$75,136,000 using CUB’s proposed rate of return.

IV. RATE BASE

A. Overview

The Commission should approve a rate base of \$6,752,566,000, as discussed in Section IV.A of ComEd's Initial Brief.⁸ Only Staff's and the AG's Initial Briefs address, other than in passing, ComEd's total rate base as such.

Staff. Staff proposes a rate base of \$6,645,499,000. Staff Init. Br., App. A, p. 4, line 23, column (d). However, Staff witness Lazare's erroneous plant adjustment – which is shown to be wrong in Section IV.C.1.b of each of ComEd's briefs – alone has a net impact on rate base of \$104,600,000. If Staff's figure is corrected to eliminate this proposed disallowance, then Staff's proposed rate base would be \$6,750,099,000. *See* Staff Init Br., App. A, p. 5, column (e).

The AG. The AG proposes a rate base of \$6,146,965,000. *See* AG Init. Br. at 2-3. However, the AG/CUB proposal to add post-test year depreciation expenses and deferred income taxes related to test year plant through the third quarter of 2008 to the Depreciation Reserve and ADIT – a proposal that is shown to be unlawful and unfounded in Sections IV.C.2 and IV.C.3 of each of ComEd's briefs – alone has a rate base impact of \$781,850,000. Correcting just that improper adjustment would increase the AG's proposed rate base to \$6,928,815,000.

⁸ This rate base figure fully reflects ComEd's limited waiver embodied in the Staff/ComEd Stipulation. In the course of preparing its briefing, ComEd discovered that its downward adjustment to rate base of \$48,802,000 in ComEd Ex. 40.01, Sched. RB-1, line 11, column (G), contains a typographical error and should have been \$49,802,000. If that adjustment is approved, then ComEd will perform the necessary corrections to its rate base and revenue requirement in preparing its compliance filing.

B. Uncontested Issues

1. Plant (Uncontested)

a. Major Capital Additions (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 4.

b. Capitalized Incentive Compensation Not Allowed in 2005 Rate Case (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 4.

c. Capitalized Information Technology Costs (Uncontested)

This issue remains uncontested.

d. Merger Costs (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 5.

e. Contested Staff-Proposed Adjustments That Are Uncontested If the Set of Resolutions Reflected in the Staff/ComEd Stipulation Is Approved

Alone among intervenors, the AG asserts that the Commission does not have the authority to approve the Staff/ComEd Stipulation. The AG mischaracterizes the Stipulation and what ComEd asks. ComEd is not asking the Commission to “approve” the Staff/ComEd Stipulation. Instead, ComEd and Staff jointly have asked the Commission to make various findings on the merits of certain contested issue, each recommendation of which is independently supported by substantial evidence in the record. That evidence includes not only testimony and documentation submitted by ComEd, but testimony from Staff as well. A summary of that evidence is included in the table below.

<u>ComEd / Staff Recommended Resolution</u>	<u>Supporting Record</u>
<p><u>Pro Forma Capital Additions:</u> ComEd has substantiated its <i>pro forma</i> capital additions both through the first two quarters on 2008, and through the first three quarters of 2008.</p>	<p>Donnelly Reb., ComEd Ex. 21.0 Corr., 2:27-5:102, 8:156-69:1377, ComEd Ex. 21.02 (public), ComEd Ex. 21.App.; Donohue/Williams Reb., ComEd Ex. 24.0, 2:6-21, 3:38-8:140, 15:299-21:426, <i>passim</i>; Donnelly Sur., ComEd Ex. 36.0, 1:22-2:29, 12:249-17:360; Griffin Reb., Staff Ex. 15.0 Corr., 5:98-7:143, Sched. 15.2; Griffin, Tr. 675:4-8; Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 9:181-18:380, ComEd Ex. 25.01, Sched. B-2, ComEd Ex. 25.02, Work Papers WPB-2.1a, WPB-2.1b; Houtsma/Frank Dir., ComEd Ex. 7.0 Corr., 34:659-36:693</p>
<p><u>Actual Pro Forma Additions through June 2008:</u> ComEd voluntarily and conditionally (if other recommendations are accepted) waives its claim to capital additions placed in service in the third quarter of 2008 and to amounts in excess of actual capital additions during the first two quarters of 2008 (on a combined basis) if actual <i>pro forma</i> capital additions are less than projected for that period.</p>	<p>Donnelly Sur., ComEd Ex. 36.0, 13:260-15:301; Griffin Reb., Staff Ex. 15.0 Corr., 5:98-7:143, Sched. 15.2</p>
<p><u>Staff Plant in Service/Accumulated Depreciation Adjustment:</u> Staff withdraws its proposed adjustment to plant in service and accumulated depreciation for 2007 as set forth in the Mr. Griffin's direct testimony (Staff Ex. No. 2.0, lines 4:73-9:171).</p>	<p>Griffin Reb., Staff Ex. 15.0 Corr., 8:144-49, 8:155-9:171; Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 10:191-208, 23:471-26:542, ComEd Ex. 25.01, Sched. B-1, Sched. B-2, Sched. B-2.1, ComEd Ex. 25.02, Work Papers WPB-2.1a, WPB-2.1b; Houtsma/Frank Sur., ComEd Ex. 40 Corr., 3:49-61, ComEd Ex. 40.01, Sched. RB-1; Griffin, Tr. 674:2 - 679:16; Houtsma/Frank Dir., ComEd Ex. 7.0 Corr., 18:323-34, 34:659-36:693</p>

<u>ComEd / Staff Recommended Resolution</u>	<u>Supporting Record</u>
<p><u>Staff Accounting Adjustments:</u> Staff withdraws its proposals for the following accounting adjustments:</p> <ul style="list-style-type: none"> a. Allocation of common plant for substations according to the proportion of the distribution facilities and transmission facilities that are at the plant (Griffin Dir., Staff Ex. 2.0 Corr., 22:423-25:490) b. Changes to ComEd’s Property Unit Catalog (Id. at 14:266-16:309) c. Capitalization thresholds for software developed or obtained for internal use (Id. at 8:163-11:215) d. Inclusion of contractor labor costs in the base for loading of departmental overheads (Id. at 11:216-12:242) e. Stores clearing account (<i>Id.</i> at 12:243-13:265) 	<p>Griffin Reb., Staff Ex. 15.0 Corr., 8:144-49, 8:150-54, 9:172-12:236; Waden Reb., ComEd Ex. 26.0, 2:33-4:77, 6:124-20:451; Frangipane Reb., ComEd Ex. 27.0, 2:23-3:57, 6:124-22:509; Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 19:402-21:436, 51:1060-64; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 9:189-94</p>
<p><u>Staff Rate Case Expense Adjustment:</u> Staff withdraws its proposed adjustment to rate case expenses set forth in Griffin Dir., Staff Ex. 2.0 Corr., 18:361-19:380 and Schedule 2.8, line 5.</p>	<p>Griffin Reb., Staff Ex. 15.0 Corr., 12:237-13:250; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 28:618-29:631, ComEd Ex. 40.01, Sched. RR-2, ComEd Ex. 40.02, Work Paper WPRR-3; Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 64:1329-66:1361</p>

Moreover, ComEd has expressed a willingness, if the Commission adopts these recommendations based on the record, to reduce its requested rate base and operating expenses, and thus its revenue requirement, below the maximum level supported by the evidence. That conditional concession reduces ComEd’s rate increase to \$314.451 million, \$30.953 million below its proven actual revenue deficiency of \$345.404 million, as discussed in Section II, *supra*. Any claim by the AG that ComEd cannot make in this proceeding the concessions contained in the joint recommendations is simply wrong, and the AG cites no authority for such a claim. Indeed, if the AG were correct, the Commission would be required to increase ComEd’s revenue requirement by that \$30.953 million.

All that the AG points to, instead, are “settlement” cases that do not apply to the Staff/ComEd joint recommendations. The AG, in particular, argues that the Illinois Supreme

Court considered the issue of “partial settlements” (settlements entered into by some but not all of the parties) in *Business and Professional People for the Public Interest v. Illinois Commerce Comm’n*, 136 Ill.2d 192, 216-18 (1989) (“*BPI I*”). What *BPI I* prohibited is imposing a result on non-consenting parties by reason of a partial settlement. ComEd and Staff in this case are not urging the Commission to accept their joint recommendations because ComEd and Staff agreed to them, but rather because they are supported by the record. It is no more a “settlement” because Staff and ComEd support common recommendations than it is a “settlement” when members of REACT, IIEC, or RESA – or, for that matter, the AG and CUB – decide to support the same issue resolutions. Also, simply because the Stipulation was admitted into the record to make their joint position clear does not mean that ComEd and Staff are asking for approval of a settlement. Rather, the Commission should decide the AG’s arguments on each issue on the merits, with the full knowledge that both Staff and ComEd do not agree with the AG.

There is no doubt that the record supports the Staff and ComEd joint recommendations. ComEd has proven its rate base and operating expenses in amounts exceeding the levels provided for in the Staff/ComEd Stipulation. For example, ComEd has justified the inclusion of *pro forma* plant additions through the third quarter of 2008, consistent with the Commission’s rules. The Stipulation itself recites some of the record evidence upon which it is based.⁹ However, under the Stipulation, ComEd has agreed to make a limited waiver of its rights, *i.e.*, to accept in this case inclusion in rate base of only two quarters of *pro forma* capital additions in 2008, less than that to which it would be entitled under the evidence and the law. Because, as

⁹ The evidence, however, is not limited to that expressly cited in the Stipulation itself. It also includes, *e.g.*, relevant portions of: Griffin Reb., Staff Ex. 15.0 Corr., and all of the evidence submitted by ComEd supporting its test year rate base and operating expenses and *pro forma* adjustments thereto. That evidence is cited and discussed throughout the relevant sections of ComEd’s briefs. Repeating the citations to all that evidence here would literally require a one-page footnote.

ComEd explained in its Initial Brief, a greater amount of capital additions is fully supported by the record, clearly the capital additions that are the subject of the Stipulation are also supported by the record.

The Stipulation's reference to the Original Cost Audit and the Audit Report also does not support the AG's position. The opposite is actually true. The Stipulation reflects reductions to ComEd's revenue rate base and operating expenses related to the audit that would not be possible at this stage of the case without the concessions that ComEd made under the Stipulation. There is absolutely no proposed component of, or increase in, ComEd's rate base or revenue requirement that is based on the Original Cost Audit or the Audit Report. Moreover, to say, as the AG does, that the Stipulation is "premised on an analysis of an audit that is not in [sic] record" is misleading and wrong. *See* AG Init. Br. at 4. ComEd and, presumably, Staff considered their own respective evaluations of the Audit Report in evaluating the Stipulation. But, they do not ask the Commission to act based on those evaluations, or on the results of the Audit, or the Audit Report. Indeed, nothing in the Stipulation or in any recommendation that Staff and ComEd make in this docket prevents any other party from litigating in the Audit Approval Docket (Docket No. 08-0312) any of the issues relating to the Audit or discussed in the Audit Report. Any resolution of those litigated issues can be incorporated into ComEd's next rate case. This is precisely what the Commission envisioned in its Interim Order in Docket No. 05-0597 that initiated the audit.¹⁰

¹⁰ The Interim Order in Docket No. 05-0597 states that "ComEd shall reflect the changes, if any, required by the Commission [in the Audit Approval Docket] on its books and records. Nothing shall preclude recognition of such changes in any subsequent case or proceeding before this Commission." Docket No. 05-0597 (Interim Order, April 5, 2006) at 2-3. It also provides that: "Parties may contest the validity and correctness of audit findings and their rate case revenue requirement impacts ... Staff and all parties in the Audit Approval Docket may introduce evidence from their own witnesses in addressing or contesting the auditor's evidence." *Id.* at 4.

In sum, the Commission should accept the joint recommendations in the Staff/ComEd Stipulation because the evidence supports them. No legal impediment bars the Commission incorporating in the final Order in this Docket the recommendations supported by the evidence simply because they are recommended by the Staff/ComEd Stipulation. Moreover, if the AG's attacks on the Stipulation had any merit, that would only result in rejecting some or all of ComEd's concessions in the Staff/ComEd joint recommendations, thereby increasing rate base and operating expenses and, thus, the required rate increase.

2. Construction Work in Progress (CWIP) (Uncontested)

This issue remains uncontested.

3. Materials and Supplies (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 10.

4. Other Post-Employment Benefits (OPEB) (Uncontested)

This issue remains uncontested.

C. Contested Issues

1. Plant

a. Pro Forma Capital Additions

i. Propriety of Additions

In its Initial Brief (at 5-6), the AG argues that the Commission should determine ComEd's *pro forma* capital additions based on a contested extrapolation from the costs and completion schedules of different projects completed last year while rejecting overwhelming evidence concerning the actual projects. This argument is inconsistent with the law and the evidence. ComEd's proof of its actual *pro forma* capital additions was extensive,

comprehensive, and uncontradicted in the record. ComEd Init. Br. at 17-19. It is specific to the actual investments being added to rate base. There was no deficiency in that proof. The AG, however, asks the Commission to ignore that evidence and, indeed, to ignore the projects actually being placed in service, and to instead rely solely on a mechanistic formula based on last year's data, an approach that has never before been used by the Commission to determine *pro forma* capital additions. The Commission should not rely on an extrapolation – especially one based on different projects – when actual data is available.

The AG dwells on the words “projections” and “forecasts” in an effort to mischaracterize ComEd’s 2008 capital additions as nebulous and uncertain. ComEd’s proof is neither. ComEd described with particularity every project of \$100,000 or more, and the record contains evidence of the need for the projects, their timetables, and the budgets associated with completing them. Donnelly Reb., ComEd Ex. 21.0 Corr., 8:158-69:1377 and ComEd Ex. 21.App. Similarly, with blanket programs that encompass smaller tasks and repetitive work, ComEd also established the actual work plans for the first three quarters of 2008, as well as the status of the completed and in process work. Donnelly Reb., ComEd Ex. 21.0 Corr., 22:471-23:498 and ComEd Ex. 21.App. All of this evidence was reviewed by outside consultants who, after also interviewing ComEd project managers, concluded that ComEd would carry out its work plan and make the forecast capital additions in the first three quarters of 2008. Donohue/Williams Reb., ComEd Ex. 24.0, 16:318-321. Further, by the time of the hearings, Mr. Donnelly was able to confirm that any variances from the planned expenditures would be within the limits ComEd had previously set forth in prefiled testimony. Donnelly, Tr. 563:2-11. Staff also reviewed and found persuasive ComEd’s evidence, although in light of ComEd’s limited waiver to restrict 2008 capital additions to the first two quarters of 2008 under the Staff/ComEd joint recommendations, Staff’s review

was focused on those quarters. Griffin Reb., Staff Ex. 15.0 Corr., 6:117-7:143. The AG did not rebut this evidence, and no evidence calls any of the supporting project data into question.

The AG's argument is also contrary to the law. Section 287.40 of the Commission's Rule requires these adjustments to be "individually identified and supported in the direct testimony of the utility." 83 Ill. Admin. Code § 287.40. That is what ComEd did. *See* ComEd Init. Br. at 17-19; *see also, e.g.*, ComEd Ex. 7.2, Work Papers WPB-2.1a, WPB-2.1b; ComEd Ex. 25.02, Work Papers WPB-2.1a, WPB-2.1b. The rule also requires that "attrition or inflation factors shall not be substituted for a specific study of individual ... expense components." ComEd's method of setting forth the specific proposed additions, individually broken out and totaled up, is the proper way to determine what additions are known and measurable. Substituting the average of additions in 2007 for the amounts shown, by contrast, is exactly what is prohibited. Moreover, given that the level of investment in 2008 is demonstrated to be higher than in 2007, accepting the AG's argument would deny ComEd recovery on assets that Commission rule explicitly authorizes ComEd to include in rate base. *See* 83 Ill. Admin. Code § 287.40. Indeed, adopting an extrapolation in place of uncontested proof of actual project investment would be contrary to the Commission's basic obligation to decide the issues based on the evidence in the record, 220 ILCS 5/10-103, 10-201(e)(iv)(A), as well as to the Commission's rules. *West Ohio Gas Co. v. Public Utilities Comm'n of Ohio (No. 2)*, 294 U.S. 79, 82 (1935).

Finally, given ComEd's limited waiver of third quarter additions under the Staff/ComEd joint recommendations and willingness to limit voluntarily its request to *pro forma* capital additions actually placed in service by June 30, 2008, the AG's position becomes even more unreasonable. As this brief is being written, the *pro forma* capital additions included for the first

two quarters are nearly all complete. Donnelly Sur. ComEd Ex. 36.0, 12:248-259; Staff/ComEd Joint Ex. 1 at 3. If ComEd has not actually made the level of additions called for by its work plan and supported by its evidence, as the AG suggests, ComEd's rate base will be limited to the actual investments. *Id.* at 3. An award of anything less would lack record support and be reversible error.

ii. Impact on Test Year Rate Base

(a) Accumulated Provisions for Depreciation and Amortization

Please *see* Section IV.C.2.

(b) Accumulated Deferred Income Taxes (ADIT)

Please *see* Section IV.C.3.

b. Underground Cable and Services

i. Introduction

In 2005 and 2006, ComEd spent \$609 million on underground cable (\$482 million) and new services (\$127 million) for customers. These are real delivery assets that are indisputably used and useful in serving customers. ComEd proved that these assets were acquired prudently and not a shred of evidence suggests that any of them could have been acquired at a lower cost.

Staff asks the Commission to disallow \$111 million of this essential investment, for no sound or defensible reason. Staff first criticizes ComEd for not providing information “explaining” the individual components of these aggregated costs – information that is not required by Commission rules, has never before been required of a utility and that ComEd does not maintain. Then, based on erroneous calculations, Mr. Lazare argues that this \$111 million of underground cable and services actually serving customers should be removed from rate base

because ComEd has not explained what Mr. Lazare considers to be an unusual increase in the cost of underground cable and services. Staff Init. Br. at 17.

Mr. Lazare's proposed disallowance is inconsistent with proper ratemaking standards, and at odds with standard methods of proceeding and proof in rate cases before the Commission. ComEd proved that the underground cable and service lines it installed are used and useful and that they were acquired prudently and at reasonable cost. McMahan Dir., ComEd Ex. 5.0 Corr., 34:710-14; G. Williams Dir., ComEd Ex. 4.0 2nd Corr., 41:782-42:807. ComEd proved that they were used in appropriate projects. Donnelly Reb., ComEd Ex. 21.0 Corr., 33:672-34:678, 42:857-66. Further, ComEd proved that the assets were acquired under rigorous cost controls and management processes that assured prudence. G. Williams Dir., ComEd Ex. 4.0, 41:782-42:819; McMahan Dir., ComEd Ex. 5.0 Corr., 17:343-50. The record contains no contrary evidence. Staff cannot point to a single cable or service asset that is not used or useful, was purchased or installed imprudently, or that could have been acquired at the time for a lower cost. ComEd Init. Br. at 23-25; Lazare Tr. 1746:6 - 1747:10. Under these circumstances ComEd is legally, indeed constitutionally, entitled to recover its costs. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944); *Bluefield Waterworks v. Public Service Comm'n*, 262 U.S. 679, 690 (1923).

Moreover, it has never been the law that a utility, to support its rate request, must identify, explain and justify every individual component of an investment or group of investments (distinct from the construction projects of which they were a part) as Staff seeks here with respect to underground cable and services. Neither Commission rule nor long-standing practice requires a utility to explain why the prudent and reasonable costs of equipment that it purchases and installs have increased; it only needs to prove that it acted prudently and that the

costs were reasonable. To be sure, this is not a case in which ComEd has declined to produce information it has. Instead, it simply does not maintain the type or level of detail Staff apparently seeks here. *G. Williams Sur.*, ComEd Ex. 37.0, 2:36 – 3:47. If the Commission does decide that utilities should maintain and produce this level of detail, it should amend its rules prospectively to so provide. It would, however, be unlawful for the Commission to disallow costs because the Commission decides – retroactively and without notice – that a utility should provide information beyond that specified by the rules. For just this reason, the courts have long held that a utility has no duty to respond to and overcome every speculative or unfounded criticism levied against its presented costs, or to produce whatever kind of substantiating evidence any other party desires. *See Illinois Power Co. v. Illinois Commerce Comm’n*, 339 Ill. App. 3d 425, 439-40 (5th Dist. 2003) (reversing Commission decision which “created after the fact the standard of care ... and applied it in hindsight to judge the prudence” of the utility’s decision). If that were the standard to be applied in a rate proceeding, no utility could ever justify any revenue requirement. Here, Staff presented no legitimate or sound analysis that undermined the presumption or proof of prudence and reasonableness accorded ComEd’s costs.

As discussed more specifically in the following sections, the record amply supports the following conclusions, all of which require that Mr. Lazare’s adjustment be rejected:

- The underground cable and services were placed into service at reasonable cost and are used and useful in serving customers.
- ComEd provided more than enough information to allow the Commission and other parties to verify those facts.
- Mr. Lazare’s “calculation” of unexplained costs is unprecedented and riddled with fundamental errors that make that calculation wholly worthless as a basis for any

Commission action. Notably, Mr. Lazare's proposed disallowance is so dependent on arbitrary methodological choices that his claim concerning underground cable is reduced by 75% if only one year is removed from his calculation. Lazare, Tr. 1711:10 – 1717:11; ComEd Cross Ex. 15. Indeed, a reasonable alternative interpretation of his own study shows no increase in the costs he examined.

- The additional information Mr. Lazare believes ComEd should have provided has never been required before and utilities are not required to keep such information. The information would not have shed any light on the issue Mr. Lazare purported to examine. Moreover, it would be unlawful and reversible error for the Commission to base a disallowance on the absence of such information.

**ii. ComEd Established These Assets
Are Properly Included In Rate Base**

ComEd's obligation is to follow the Commission's rules regarding new plant in rate base and present evidence that those additions are used and useful in serving customers, and that they were prudently acquired at reasonable cost. 220 ILCS 5/16-108(c); *Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 121 (1995). The Commission's rules are quite clear as to the obligations imposed upon a utility in its initial filing and in its initial testimony with respect to additions to rate base. 83 Ill. Adm. Code Section 285.6100 prescribes what the utility must provide in the Part 285 filing as to major additions to rate base, the so-called "Schedule F-4" projects, and 83 Ill. Adm. Code Section 286.20(a)(2) specifies what the utility must include in its direct case about the Schedule F-4 projects. In its initial filing, ComEd met each of the Commission's requirements relating to additions to rate base since its last rate case. The

testimony of Mr. McMahan described all the Schedule F-4 projects as well as relevant supporting documents.

Beyond that, ComEd introduced a raft of evidence showing the prudence, reasonableness and cost justification for all of its additions to rate base, including underground cable and services. Mr. Williams explained that all investments made by ComEd are subjected to rigorous operational and financial review. Mr. Williams described the stringent internal controls and strong oversight of vendor selection and management employed to ensure that costs are reasonable. G. Williams Dir., ComEd Ex. 4.0, 42:808-19; 55:1076 - 56:1101. Mr. McMahan further explained that ComEd manages every capital project either as a unique project (all projects over \$100,000) or as a blanket project (individual projects under \$100,000). He testified that in 2005 and 2006 ComEd installed \$770 million of plant additions as blanket projects. He explained the nature of the blanket programs and described how the costs of such blanket projects are managed, controlled, accounted for and reported. McMahan Dir., ComEd Ex. 5.0 Corr., 30:626 - 31:661.

Mr. McMahan also explained that ComEd retained the energy consulting firm, Power Delivery Resource & Consulting Corp. ("PDR&C") to perform a top-down review of ComEd's major capital projects and its largest blanket programs. In the course of that work, PDR&C interviewed ComEd personnel, gathered relevant project related documentation, and drafted evaluations of the projects analyzed. ComEd, according to Mr. McMahan, relied upon the PDR&C reports and supporting documentation to support its conclusion that its investment in each of the projects was prudent, that the costs incurred were reasonable and that the investment is used and useful in providing utility service. McMahan Dir., ComEd Ex. 5.0, 15:315 - 16:322. Of particular relevance to the present issue, Mr. McMahan testified that in 2005 and 2006,

ComEd spent \$285.8 million on the installation of 25 million feet of cable and wire for 106,700 new services for residential and commercial customers. PDR&C also studies the eight blanket programs through which ComEd, in 2005 and 2006, installed those new services. Two PDR&C reports in this area are of particular significance: “Install New Services for Residential Customers” and “Install New Services for Commercial Customers (both June 25, 2007). PDR&C prepared a separate report that explained the \$126 million in capital costs ComEd incurred through five blanket programs involving underground cable replacement and installation: “Emergency Replacement of Electrical Underground Equipment” (June 25, 2007).

In the face of this evidence, Staff’s claim that these “adjustments are necessary because ComEd has thoroughly failed to provide reasonable evidence justifying the levels of its proposed additions” (Staff Init. Br. at 13) is meritless. The following table summarizes the extensive evidence, in addition to that set forth above, ComEd presented in support of its capital projects, including the underground cable and services that are the subject of the Staff adjustment. The table also reflects Staff’s examination and analysis of ComEd’s case, as well as any contradictory evidence. It demonstrates that ComEd’s evidence is un rebutted and largely unexamined:

ComEd’s Proof	Staff’s Examination and Analysis of ComEd’s Proof	Contradictory Evidence
ComEd’s underground cable and services are used and useful. ComEd Ex. 4.0 2 nd Corr., 41:782-42:807.	None.	None.
ComEd’s management decided to acquire and install cables and services prudently at the time. ComEd Ex. 4.0 2 nd Corr., 42:811-819.	None. Tr. 1727:17-21.	None. <i>See</i> Tr. 1747:14-17.

ComEd's Proof	Staff's Examination and Analysis of ComEd's Proof	Contradictory Evidence
Raw materials and cost of labor have increased. ComEd Ex. 22.0 2 nd Corr., 4:78-86; 11:221-23.	None. Tr. 1746:2-5.	None. See Tr. 1701:3 - 1703:2.
ComEd management has controls in place to ensure reasonable costs (contractors of choice, challenge process, capital approval process, accounting cost procedures and controls). ComEd Ex. 4.0 2 nd Corr., 41:782-42:819.	None. Tr. 1726:12-19.	None. See Tr. 1747:5-10.
Projects over \$100,000 get special processes and professional project managers. ComEd Ex. 5.0 Corr., 9:167-13:277.	None. Tr. 1719:21 - 1721:15.	None. See Tr. 1720:4-8.
Services and many underground facilities are managed as "blanket" programs. These were summarized, analyzed, evaluated, and found prudent by outside experts. ComEd Ex. 24.0, 3:32 - 4:44; 9:164-74.	None. Tr. 1739:5 - 1740:6.	None. See Tr. 1733:18 - 1734:15.
ComEd submitted information and documentation on largest capital additions in accordance with Part 285.6100 and 286.20(a)(2), and for the next 10 largest capital additions and blanket programs. ComEd Ex. 5.0 Corr., ComEd Ex. 5.1.	Mr. Linkenback analyzed ComEd's evidence and other data and proposed no disallowances. Staff Ex. 8.0, 22:470-24:509. Mr. Lazare did not examine this data at all. Tr. 1732:6-18.	None. See Linkenback Dir., Staff Ex. 8.0, 22:470-24:509.

ComEd's evidence was more than "reasonable." It went far beyond what is required by the Commission's rules and practice and was more than sufficient to establish that these assets are properly included in ComEd's rate base. Although ComEd's initial filing may not have explained in detail the *specific reasons* for every increase in the cost of every component of these assets, nothing in the Commission's rules or long-standing practice requires that this be done.

Mr. Williams' testimony about the causes of increases in ComEd's rate base, cited by Staff as inadequate (Staff Init. Br. at 14-16) was not intended to be an exhaustive or detailed breakdown of all factors leading to cost increases, but it did correctly identify the trends driving the increased costs of ComEd's investment in new infrastructure. Staff's assertion that Mr. Williams' evidence was not "meaningful support" for rate base additions (Id. at 14) misses the mark. It was not intended to explain the increase in each dollar spent, as no such requirement exists.

In any case, Mr. Williams described at some length the various factors that were causing ComEd's investment costs to increase. He presented examples of the steep increases in equipment such as cable, poles and transformers. He described the extraordinary price increases in such commodities as copper that resulted from strong worldwide demand for such commodities. G. Williams Dir., ComEd Ex. 4.0 2nd Corr., 13:251 – 14:257. Mr. Lazare acknowledged that costs of construction labor were increasing at rates double that of ordinary inflation. All of this information was made available to Mr. Lazare in an effort to assist him in his analysis.

In any event, no party refuted the balance of Mr. Williams' testimony wherein he showed that, apart from the reason for any cost increase, the assets ComEd placed into rate base were in fact acquired prudently and at reasonable cost. This evidence, where and how the dollars were spent and the controls to which the spending was subject, is the best explanation refuting any claim that costs were incurred unreasonably. Staff's claim (Staff Init. Br. at 18) that ComEd did not meet its initial burden is simply wrong.

iii. Mr. Lazare Failed To Raise Any Legitimate Question About The Cost Of Underground Cable Or Services

Mr. Lazare offered nothing to contradict ComEd's evidence. He did not identify a single unit of cable or service connection that is unneeded, that should not have been purchased, or that could have been purchased at a lower cost. Tr. 1746:2 - 1747:17; G. Williams Sur., ComEd Ex. 37.0, 4:70-73. He did not compare ComEd's costs to those of any other Illinois utility or any other utility in the country or to any recognized industry benchmark. Tr. 1698:20 - 1699:7. Indeed, as noted in the table above, Mr. Lazare did not analyze, inquire about or even review most of the information that proved ComEd's investments to be appropriate. Id. at 1729:14-1732:18; 1729:1-13. Mr. Lazare did not review any of the three PDR&C reports identified above that relate to underground cable and services even though the reports were made available to him more than two months before he filed his rebuttal testimony. Id. at 1737:6-1740:6. He did not investigate the basis for any of the conclusions cited above. ComEd established data rooms containing a great deal of additional plant data that Mr. Lazare did not examine. Id. at 1734:6-12. Given Mr. Lazare's complete failure to inform himself of the facts underlying ComEd's addition of underground cable and services, his criticism of the quality of evidence ComEd presented is entitled to no weight.

iv. Mr. Lazare's Calculation of "Increased Costs" Is Incorrect

Staff's conclusion of an "unusual" increase is premised entirely on Mr. Lazare's misguided analysis. In brief, what Mr. Lazare did was to compare average per unit (per mile) costs for underground cable and services between two time periods: the five-year period 2000-2004 and the two-year period 2005-2006 (when investments in the test year rate base were made). Mr. Lazare made assumptions about the percent of cost accounted for by materials and

non-materials, respectively, and also made assumptions about what an “expected” escalation rate would have been. He concluded that the actual escalation between average per unit costs between the two time periods exceeded an expected escalation rate by \$111 million. He spent a total of *eight hours* on this work. Tr. 1747:18-22.

Contrary to what Staff asserts, Mr. Lazare’s abbreviated “analysis” does not substantiate any unusual increase in costs, or that ComEd “overspent on plant.” Staff Init. Br. at 22. The method adopted by Mr. Lazare is not supported by any recognized authority, has never been accepted by this or any other Commission and is not derived from any recognized economic, statistical or ratemaking model. In addition, each step of Mr. Lazare’s analysis is flawed and the end product is a result that is unreliable.

Step 1: *Use average unit costs to evaluate how costs are managed.*

Wrong. By using entire USOA account balances as his numerator, the costs include an array of rolled-up costs. Thus both the “cable cost” and “services cost” figures from which he starts are erroneous. USOA 366, for example, includes “manholes, concrete, ventilation equipment, sump pumps, temporary installations for the permanent installation of conduit, permits, municipal inspections” and other things. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 4:68-70. In reality, Mr. Lazare has not calculated unit costs of underground cable or services, but rather unit costs of entire FERC accounts (366, 367 and 369), accounts which include a wide array of costs.¹¹

His math is not dissimilar to a shopper trying to calculate the per mile cost of driving

¹¹ Mr. Williams did not criticize the Lazare analysis for *failing* to consider these other costs, as Staff suggests (Staff Init. Br. at 22, 23); instead, Mr. Williams properly criticized the Lazare analysis for lumping together *too many* cost items in the numerator and then pretending the resulting unit costs were something they clearly were not. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 3:50-58.

to the grocery store by dividing the number of miles driven into the cost of not only the gasoline purchased for the trip but also the cost of eggs, flour, milk, butter and potatoes bought at the store.

ComEd provided to Mr. Lazare during discovery specific information, from the ComEd Distribution System Data Book, on the type of unit costs Mr. Lazare was trying to recreate. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 5:87-101. Staff's criticism of this information on grounds it is not based on USOA accounts is no criticism at all inasmuch as, as shown above, the USOA accounts mask the true unit costs in ways that the Data Book does not. Mr. Lazare's real criticism of the Data Book is that it refutes his analysis.¹²

With respect to service lines, the costs vary substantially depending upon whether they are for a residential (*e.g.*, \$1,500) or commercial (*e.g.*, \$5 million) customer, and the presence of a few large commercial installations in any one year can badly skew the total for that year and thus distort the significance of any averages.

¹² In its effort to find alternatives to ComEd's figures, Staff made a misstatement in its Initial Brief concerning Mr. Williams' testimony that needs to be clarified. Staff cites its cross-examination of Mr. Williams for the proposition that per unit cost of underground cable was \$359,000 per mile. This calculation incorrectly assumes that ComEd replaced no existing cable, but just added new miles. Staff Init. Br. at 25; G. Williams, Tr. 760-761. For dollars, Staff used the total incremental increase in the number of dollars invested in cable from 2005 to 2006, \$71.8 million. Staff counsel then asked the witness to divide that dollar figure by the difference in the incremental increase in length of cable on ComEd's system for 2005 versus 2006, a mere 200 miles of cable. Staff ignores the fact that a large amount of the \$71.8 million represents investment in new cable *to replace existing cable* – investments that do not add to the total length of cable in the system. On cross-examination, Mr. Lazare agreed that the proper method of calculating unit costs is shown on ComEd Cross Ex. 18 (Lazare, Tr. 1745:6 - 1746:1) (factoring in both new *and* replacement cable) and not the method Staff uses in its Initial Brief.

Step 2: *Divide cost of underground cable by the miles of new primary conductor.*

Wrong. For the denominator of his underground cable calculation, Mr. Lazare used a figure that was the number of miles of *primary* conductor, that is, relatively higher voltage distribution lines. This erroneously left out the many miles of secondary conductor that is included in the Underground Cable account. *Compare* Staff Ex. 5.2 (used 1,965 miles in calculation) to G. Williams Dir., ComEd Ex. 4.0 2nd Corr., 45:872 (ComEd added a total of 4,967 miles of underground cable since 2004).

Step 3: *Compare the average unit costs for underground cable and services only between two time periods, 2000-2004 and 2005-06.*

Wrong. For no reason that he could explain, Mr. Lazare chose to compare the average costs he calculated using the five-year time period 2000-2004 and the two year period 2005-2006. See Tr. 1704:13 - 1707:18. It turns out that this particular set of years is critical to Mr. Lazare's findings. As ComEd demonstrated in its Initial Brief (at 26-28), the cross-examination of Mr. Lazare confirmed that Mr. Lazare's supposed "unexplained" increase is largely a function of inclusion in his analysis of the obviously atypical (and most distant) year, 2000 - - even accepting *all* of Mr. Lazare's other assumptions and the methodology itself. Tr. 1711:10 - 1717:11; ComEd Cross Ex. 15 (Lazare adjustment for underground cable reduced by 75% simply by removing year 2000 from the data). An analysis that is so dependent on changes in the data set employed cannot reasonably serve as the entire basis for any meaningful conclusion, much less a \$111 million rate base disallowance.

Step 4: *The 48% “calculated” increase in underground cable costs is unreasonable.*

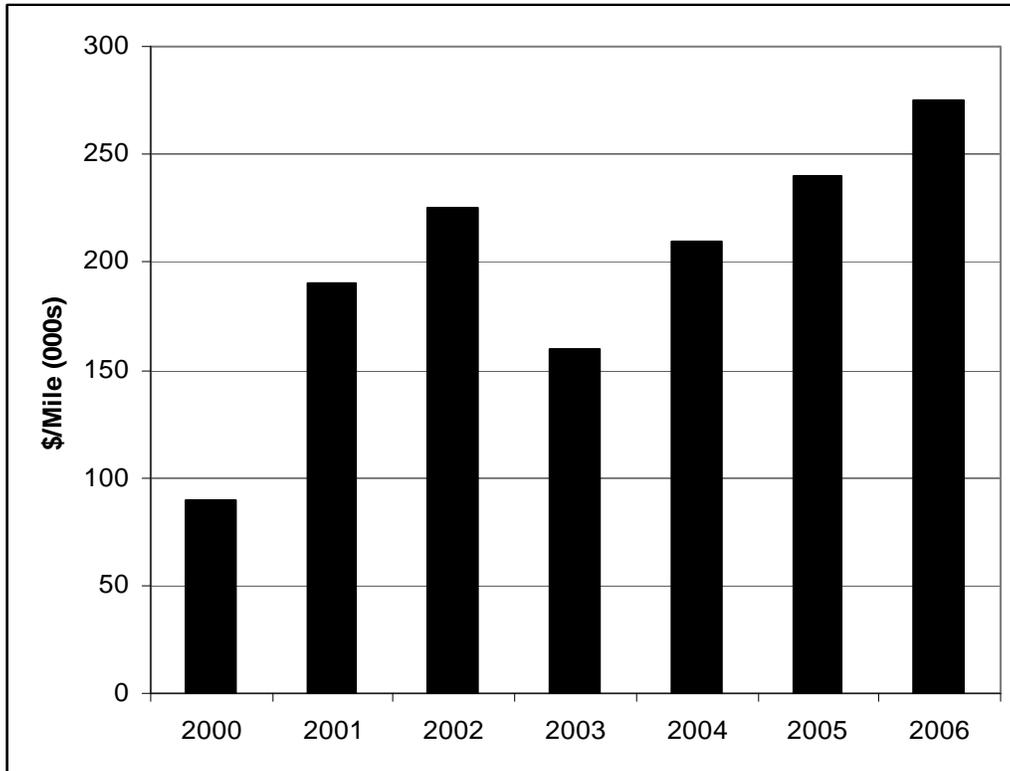
Wrong. Mr. Lazare simply assumes that this increase is inherently unreasonable. He failed to compare his figures to any industry benchmarks or real-world utility data. Tr. 1698:20 - 1699:7. He also failed to take inflation into account, an elementary mistake for an economist. Tr. 1699:8-14. In fact, he admitted that distribution plant costs increased 34% between January 2004 and January 2007, a rate that exceeded four times the rate of general inflation. Tr. 1702:11 - 1703:2.

Step 5: *Calculate a hypothetical proxy for an allowable rate of increase.*

Wrong. Mr. Lazare assumes a 3.5% per year rate of increase of all non-materials costs, based solely on the ComEd wage increases, and ignoring all other costs. Lazare Dir., Staff Ex. 5.0, 24:529-38. He accepted, during cross-examination that between 2001 and 2007 the costs of craft labor and heavy construction labor increased by about 26% while the cost of common labor increased by about 27%, or almost twice the rate of general inflation. This is the type of labor ComEd employs in performing the work that is the subject of Mr. Lazare’s two adjustments. Tr. 1703:12 - 1704:9. He assumes an increase in materials costs equal to the rate of increase in certain cable conductors. Lazare Dir., Staff Ex. 5.0. at 16:349-54. As set forth in the discussion of **Step 4**, once again he failed to compare his figures to any industry benchmarks or actual utility data, or take inflation into account.

Even aside from the numerous methodological errors described above, the results of the “model” are meaningless on their face. A quick look at the Staff exhibit that summarizes these increases (Lazare Dir., Staff Ex. 5.0, Schedule 5.1) shows that average per unit costs fluctuate

wildly on a year-over-year basis, ranging between \$96,448 (2000) and \$270,657 (2006) per mile for underground cable, as shown in the chart below (derived from Mr. Lazare’s Schedule 5.1).



Clearly, such grossly fluctuating “per unit” costs suggest that many extraneous factors must be clouding the analysis, but Mr. Lazare ignores all external factors entirely.

More significantly, alternative ways of looking at Mr. Lazare’s own data show that the 2005 and 2006 “per unit” costs, even taken at the face value Mr. Lazare would assign to them, are not out of line with prior costs. For example, in 2002, the “per unit” cost was \$217,990; if that were escalated at 4% per year, corresponding numbers for 2005 and 2006 would be \$245,209 and \$255,017 respectively (or a per-mile weighted average of \$245,401). Actual ComEd numbers as reflected on Mr. Lazare’s schedule 5.1 were actually less than that: \$225,498 and \$270,657, respectively (or a weighted average of \$245,170). Looked at this way, Staff’s own numbers show no increase at all, much less an unexplained one.

v. **Mr. Lazare Seeks to Impose A
New And Unlawful Standard of Proof**

Mr. Lazare attacks ComEd for not retaining data about, and then separately quantifying and justifying, the share of each FERC account that consists of the cost of capitalized labor, as opposed to other costs, such as materials. Lazare Reb., Staff Ex. 18.0, 2:40 - 3:56. Staff cites the absence of this data as another reason supporting the recommended disallowance of \$111 million of the costs of ComEd's real delivery assets. Staff Init. Br. at 18-20. In essence, in Mr. Lazare's view, ComEd should be denied cost recovery because of a new data requirement in this case, imposed retroactively.

Mr. Lazare is wrong. To hold that ComEd cannot recover its costs unless it can provide a break down of capitalized labor by FERC account in this manner is fundamentally unfair. It is also illegal. *Illinois Power Co. v. Illinois Commerce Comm'n*, 339 Ill. App. 3d 425, 439-40 (5th Dist. 2003) (reversing ICC decision which "created *after the fact* the standard of care ... and applied it in hindsight to judge the prudence" of the utility's decision) (emphasis in original).

ComEd has never been required – by the USOA, GAAP, the Public Utilities Act, the Commission's rules, or any previous Commission order – to maintain capitalized labor costs by project. Lazare, Tr. 1741:1 - 1743:4. Staff itself has never, even informally, requested that ComEd track this data. Mr. Lazare admitted that ComEd is in compliance with the USOA, that tracking capitalized labor is not required by any law or order, and that he was unaware of there ever having been a request – of ComEd or any other Illinois utility – by Staff's accountants to maintain capitalized labor statistics. Tr. 1741:14 - 1743:10. It would be reversible error for the Commission to disallow recovery of investment because ComEd was unable to provide data that it is not required to keep and has never before been required to provide.

Moreover, Mr. Lazare's complaints about ComEd's failure to provide the "evidence" he demands are red herrings that have nothing to do with his ultimate conclusions. According to Mr. Lazare, ComEd's inability to identify the "capitalized labor" included in USOA Accounts 366, 367 and 369 "means there is no way to independently assess whether the labor costs incorporated into the Company's plant additions were actually incurred" Staff Init. Br. at 21. Yet, Mr. Lazare failed to review the construction files and otherwise ignored ComEd's work-related files (Lazare, Tr. 1734:6-15) in which ComEd's labor costs are documented. ComEd explained that it does not separately maintain records of capitalized labor in its plant accounting system. G. Williams Sur., ComEd Ex. 37.0, 2:36-47.

The information Mr. Lazare sought is, at best, a starting point for a meaningful evaluation of ComEd's management decisions. If, of the \$482 million ComEd invested in plant additions for underground lines in 2005 and 2006, ComEd had reported that \$200 million constitutes capitalized labor, it is inconceivable how that information alone would be probative on the question of overall reasonableness of costs. Mr. Lazare never explains the import of that information or how it might factor into his analysis.

Mr. Lazare also complains that ComEd was unable to produce a breakdown of the costs of a variety of listed materials which must be reported in the USOA accounts. For instance, costs included in USOA Account 366 are costs related to, *inter alia*: "ventilation equipment, sump pumps... permits ... municipal inspections..." 18 C.F.R. 101, *adopted at* 283 Ill. Admin. Code §415.10. Again, Mr. Lazare does not explain how this data, if produced, would aid the Commission in reviewing ComEd's rate base. ComEd's inability to produce such breakdowns does not call for a disallowance.

In its Initial Brief, Staff has presented a new calculation that Mr. Lazare did not present in, and is contradicted by, his testimony. Staff Init. Br. at 14-15. Staff takes one of Mr. Lazare's incorrectly calculated numbers, a supposed \$207,159 per mile for underground cable, and compares it to a number picked off of a graph on page 36 of Mr. Williams' direct testimony, pronouncing the absurd result that only 1.2% of ComEd's costs of cable installations are attributed to the costs of materials. (Mr. Lazare himself estimated this figure at 27.6%. See Staff Ex. 5.2, at 2.) No testimony supports the validity of this calculation, and it is not valid. It is inappropriate to take the wrong total cost per mile figure, and compare it to an isolated cost of one type of material.

vi. **Conclusion**

ComEd provided overwhelming evidence of the prudence and reasonableness of its investment in underground cable and services. Mr. Lazare's recommended disallowance is based on the untenable position that ComEd failed to produce what it had no obligation to produce in the first instance. The disallowance is compounded by an untested "method" that is based on assumption and speculation and the results of which are unprecedented, untested, unverified and unreliable. For the Commission to reduce ComEd's rate base by \$104.6 million¹³ – or indeed any amount – based on such an unfounded approach would be arbitrary and capricious ratemaking of the worst kind, a sharp and unexplainable departure from previous regulatory practice of the kind condemned by the appellate court in *BPI v. Illinois Commerce Comm'n*, 279 Ill. App. 3d 824, 829-830 (1st Dist. 1996), and ultimately unlawful. The financial results would be severe, wiping out 25% of ComEd's anticipated earnings, already at

¹³ \$111 million gross plant net of depreciation and amortization, as shown on Staff Init. Br. App. A.

unreasonably low levels, and the ultimate impact would be one that would sabotage ComEd's efforts to restore its financial health. It would be precisely the kind of disallowance that would lead the investment community to shake its collective head in disbelief at the state of regulation in Illinois. It should be rejected.

**c. Capitalized Incentive Compensation
Other Than That in IV.B.1.b (See V.C.1.)**

Please *see* Section V.C.1.

d. Customer Advances for Construction

ComEd's rate base correctly accounts for Customer Advances for Construction. ComEd Init. Br. at 28-30. The AG (Init. Br. at 12-13) presents cursory arguments for AG/CUB's two proposals to increase the rate base reductions that ComEd already made for customer advances relating to customer-requested nonstandard equipment (\$7.904 million) and line extensions (\$22.083 million). Neither of the further reductions that AG/CUB propose is justified.

The AG contends that rate base should be reduced for all customer advances received for the purpose of funding specific projects, regardless of whether those projects are in rate base. The AG's position is erroneous. Rate base should be reduced for advances only if the specific project for which the funds were provided is in rate base. Otherwise, nothing supports imposing the AG's proposed offset. The uncontradicted evidence shows that: (1) these funds cannot be used to finance projects other than the projects for which they were supplied and (2) these funds should be used to reduce rate base only if the specific projects for which they were supplied are in rate base. ComEd Init. Br. at 29-30.

The evidence shows that ComEd has already made the appropriate credits against rate base. For advances for customer-requested nonstandard equipment that relate to a project in rate base, ComEd already has made the appropriate \$9.9 million total credit against plant additions in

rate base. *Id.* Mr. Effron’s proposed adjustment for those same advances is purely duplicative. Similarly, as to AG/CUB’s proposed adjustment for line extension deposits, ComEd already accepted, in order to narrow the issues, Mr. Effron’s proposal to use updated 2007 values (rather than 2006), but only for those line extension deposits that relate to projects in rate base. For those projects, ComEd already has made the resulting credit against rate base in the total amount of \$12.065 million. ComEd Init. Br. at 30. The additional \$10.018 million further decrease that AG/CUB seeks relates to projects not in rate base because they either are non-jurisdictional transmission projects or they are under construction and not yet complete. *Id.* Advances for projects not in rate base cannot properly be subtracted from rate base

The AG, however, attempts to cloud this issue by trying to characterize the dispute as if it were about the “normal” levels of those two types of advances, rather than the actual level, and assuming that a “normal” level is what should be subtracted from rate base. *See* AG Init. Br. at 12-13. The AG is wrong; this is not a credit that can be “normalized.” That is because, whatever their “normal” levels, only advances actually made can be used by ComEd to finance projects, and the ability to use these advances as a general source of capital for ComEd is the whole basis for the subtraction. Moreover, advances already credited against rate base cannot be subtracted again on the theory that they are part of a “normal” level of advances. Those funds cannot be counted twice.

Finally, the AG also misstates ComEd’s position to imply that ComEd’s position hinges on whether money has been spent or not; that is not the case. Much of the money that the AG believes is available to fund other projects has, in fact, been spent; however, the project that it

relates to may still be recorded as Construction Work in Progress and, therefore, not included in rate base.¹⁴

e. **Depreciable Life of Post-2006 Project**

Staff proposes to reduce the annual amortization of ComEd's Post-2006 project by \$1,487,000 and increase the Depreciation Reserve by the same amount. Staff Init. Br. at 27. Staff argues that ComEd's justification for application of a five-year amortization period to the Post-2006 project is "nothing more than the rote application of its general software amortization policy." *Id.* at 28. Staff urges the Commission to find that "the magnitude and long useful life warrant an exception to ComEd's general policy for amortization periods." *Id.* at 29. Staff's proposal is erroneous. Staff is correct that ComEd's general software amortization policy is five years (because that is when software typically becomes obsolete), and that ComEd has applied that policy to this project. Waden Reb., ComEd Ex. 26.0, 24:544-48. Staff is, however, incorrect that this project warrants an exception to that policy.

The record shows, in fact, that five years is a very appropriate depreciable life for these particular system modifications. Indeed, it shows that ComEd is already in the process of modifying these systems again, due to the continued evolution of the retail market. *See* ComEd Init. Br. at 31. Moreover, additional enhancements to software are likely to be required by the elimination of the supply auction, the advent of procurement governed by the Illinois Power Agency, and the provisions of Senate Bill 1299 related to utility consolidated billing and the purchase-of-receivables. Waden Reb., ComEd Ex. 26.0, 24:556-25:564; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 9:179-88. The environment in which ComEd operates is dynamic and

¹⁴ The AG suggests that if a customer has made an advance for a project, but the project is not yet in rate base, then that means the advance has not yet been spent. AG Init. Br. at 13. That, too, is wrong. Houtsma, Tr. 1016:6-21.

evolving, and ComEd's billing system enhancements will likely become obsolete in a relatively short period of time. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 9:179-88.

On the other hand, no evidence in the record substantiates Staff's assertion that the Post 2006 Project has a particularly long useful life that warrants an exception to ComEd's general policy regarding amortization periods. Nor does this proposed adjustment have any legal basis. Staff cannot argue that it meets any recognized standard supporting a mandatory depreciation rate change. The five-year amortization period corresponds with the reasonably anticipated useful life of the underlying asset and is appropriate.

2. Accumulated Provisions for Depreciation and Amortization

AG/CUB and IIEC propose to inflate the Depreciation Reserve by, respectively, \$693.553 or \$566.832 million, by adding post-test year depreciation expense for test year plant. As is demonstrated in subsection (a), below, those proposals are directly contrary to on point decisions of the Commission in ComEd's own 2005 and 2001 rate cases and the Commission's February 2008 Order in *Peoples Gas*. The AG's and CUB's briefs do not even mention that the Commission rejected the same AG proposal in each of those three dockets. IIEC acknowledges those three decisions, but while ostensibly attempting to distinguish them, tacitly recognizes that the Commission would actually need to "disavow" them to sustain IIEC's position. *See* IIEC Init. Br. at 5; *see also id.* at 17. As is demonstrated in subsection (b), below, such a course reversal would be unlawful under the Commission's test year and *pro forma* adjustment rules, 83 Ill. Admin. Code §§ 287.20, 287.40. The AG, CUB, and IIEC claims about those rules are meritless and the Commission's correct and on-point prior rulings should be followed.

Consistency with prior Commission decisions rejecting this proposed adjustment is especially crucial here. In *Peoples Gas*, the Commission expressly emphasized that its ruling

against the AG and CUB on this very issue was intended to “bring[] certainty to a situation and settle[] expectations.” *Peoples Gas* Order at 16. The Commission also recognized that reaching any different result on the same common facts that this case also shares “risks a charge of arbitrary and capricious action.” *Id.* Accepting the AG/CUB and IIEC proposals here thus would be incorrect under the Commission’s rules and its Orders, would violate the principles espoused by the Commission just four months ago, and would raise serious doubts about the predictability and rationality of regulation in Illinois. In short, adoption of the AG/CUB and IIEC proposals would be arbitrary and capricious and incorrect as a matter of law. *Commonwealth Edison Co. v. Illinois Comm. Comm’n*, 180 Ill. App. 3d 899, 906-10, 536 N.E.2d 724, 729-31 (1st Dist. 1988).

a. The AG/CUB and IIEC Proposals Should Be Rejected Under the Commission’s Prior Orders

Each of the Commission’s past Orders involving utilities that had significant increases in net plant year over year, including in ComEd’s own past cases, rejected the disallowance that AG/CUB and IIEC again propose. Each held it to be inconsistent with the Commission’s test year and *pro forma* adjustments rules. No lawful basis supports any different result here.¹⁵

AG/CUB and IIEC cite three other past Orders as supposed support for their proposals. They each cite the 2001 Order in Docket No. 01-0432 (involving Illinois Power (“IP”)) and the 2003 Order in Docket Nos. 02-0798/03-0008/03-0009 (Cons.) (involving both AmerenUE and AmerenCIPS). CUB also cites the 2003 Order in Docket No. 02-0837 (involving CILCO).

¹⁵ It is undisputed that ComEd’s net plant has increased by hundreds of millions of dollars per year, and that its post-test year investments have increased that pace. For example, the data submitted in Schedules B-5 and B-6 in ComEd Ex. 7.1 shows that ComEd’s net Distribution and General and Intangible Plant (*i.e.*, excluding Transmission Plant) increased by an average of \$367 million per year from 2003 to 2006. The data submitted by AG/CUB shows an increase in jurisdictional net plant in 2007 of \$449.018 million. *See* AG/CUB Ex. 5.1, Schedules B-1, B-1.1.

CUB Init. Br. at 6-7, IIEC Init. Br. at 6, *et seq.*; AG Init. Br. at 8-9 (also citing *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 238, 242 (1991)). None of those cases, however, involves facts comparable to those in this case. As those Orders themselves recognize, they involved utilities with net plant that was essentially static or declining over time, unlike the undisputed facts regarding ComEd. Thus, as the Commission has expressly found, those cases do not support AG/CUB's and IIEC's proposal.

AG/CUB's failures to address the on point Commission' orders and the relevant facts are nothing new. As the Commission in *Peoples Gas* found:

For their part, the GCI [AG, CUB, and the City] take little or no account of the facts, circumstances or findings in Docket 05-0597. Consistent with our prior and controlling decision on the issue, and for the same reasons, we here reject the GCI's proposed adjustment. While Staff and the GCI take exception with our reliance on the disposition of this issue in the ComEd orders, they make no attempt to distinguish the facts in that proceeding from the facts at hand.

Peoples Gas Order at 17.¹⁶

Not surprisingly, the Orders in ComEd's 2005 rate case and *Peoples Gas* not only find that the same proposal that AG, CUB, and IIEC make here violates the Commission's test year and *pro forma* adjustments rules, but also expressly reject reliance on the *IP*,

¹⁶ While IIEC does address some facts, it does so only selectively, ignoring most of the relevant facts. Also, IIEC's chart of past Orders (IIEC Init. Br. at 16) has the ruling in the *IP* case wrong. In the *IP* case, which used a 2000 test year, *IP* proposed *pro forma* plant additions for certain projects either funded or approved by September 30, 2001, including projects that would not be in service until at late as June 30, 2002. Docket No. 01-0432, Final Order at 10, 11, 18-19. *IP* accepted "GCI's" (the AG and CUB) proposal to increase the Depreciation Reserve by the amount of the accumulated depreciation accruing on test year plant through September 30, 2001, but *IP* opposed accepting GCI's proposal to carry that adjustment through June 30, 2002. *Id.* at 20, 21. The Commission accepted *IP*'s position and rejected GCI's argument that the adjustments to accumulated depreciation associated with test year plant should go farther than *IP* had agreed. *Id.* Thus, the Depreciation Reserve was measured at a date nine months short of when the last *pro forma* capital additions would go into service.

AmerenUE/AmerenCIPS, and *CILCO* cases, finding them to be “inapplicable and without merit.” Order in Docket No. 05-0597 at 15; *Peoples Gas* Order at 15-16.¹⁷

Attempts by AG/CUB and IIEC to distinguish their current claims from the prior AG and CUB proposals rejected by the Commission are incorrect and irrelevant. In particular:

- The AG claims that ComEd made *pro forma* adjustments that included post-test year removals in the current case but not in the 2005 case. That is not true. Post-test year removals were included as a *pro forma* adjustment in the 2005 case. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 15:334 – 17:366.
- The AG claims it makes a difference that ComEd’s *pro forma* capital additions cover a longer post-test-year period than in ComEd’s 2005 rate case; and IIEC makes a similar comment about “escalation” of that period. Neither makes a relevant point. The Commission’s Order in ComEd’s 2005 rate case did not rely on the length or the period used as a factor in its decision (Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 14:294-298), and ComEd’s additions here are indisputably within the period permitted by the rule, *i.e.*, twelve months after the case’s filing date. 83 Ill. Adm. Code § 287.40; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 13:276-288. Moreover, *Peoples Gas* approved additions entering service as much as five months past the point that the AG’s witness invoked here. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 13:289 – 14:294.
- AG/CUB claims that it makes a difference that their proposal incorporated actual data for 2007 and part of 2008. That, too, is wrong. The Order in ComEd’s 2005 rate case did not reject the AG’s proposal because it was not known and measurable, or was not

¹⁷ The Commission also ruled against the proposal now made by AG/CUB and IIEC in ComEd’s 2001 rate case. Docket No. 01-0423, Interim Order at 42-44 and Final Order at 43-45.

supported by “actual” data. The Commission rejected the proposal because it violated test year principles and other aspects of the *pro forma* adjustments rule. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 14:302 – 15:319. Moreover, AG/CUB’s argument proves too much. Its logic would permit ComEd to substitute, across the board, its actual 2007 operating expenses – which, like the 2007 Depreciation Reserve, are now known and measurable -- for its test year operating expenses, which would result in a higher revenue requirement. *Id.* at 15:324-328.

- AG/CUB and IIEC claim that depreciation expenses finance post-test year plant additions. They err again. Depreciation expense recovered through current rates by definition can only represent recovery of the cost of plant additions included in rate base in the 2005 rate case. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 17:378 – 18:397, 19:420-426. They recover no costs of any of the new additions requested in this case. *Id.*
- Finally, AG/CUB, IIEC, and the Commercial Group misstate the facts when they claim that the Commission’s Orders in the ComEd rate cases and *Peoples Gas* permit ComEd to propose “one-sided” and excessive *pro forma* capital additions that will result in rates being set above ComEd’s costs of service while those rates are in effect. *E.g.*, CUB Init. Br. at 4; IIEC Init. Br. at 4-5; Commercial Group Init. Br. at 2-3. In fact, ComEd’s rates will under-recover its costs of service in that period, even if their depreciation adjustment is again properly rejected. Even a \$314.451 million rate increase, coupled with post-test year increases in ComEd’s plant investments and operating expenses, results in ComEd earning in 2009 a return on equity of only about 8%, well below any reasonable ROE, and below even the 10.2% ROE supported by IIEC. Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 18:398 – 19:419. *See also* McDonald Reb., ComEd Ex. 28.0, 2:35 – 4:87.

In sum, the AG/CUB and IIEC proposals should be rejected as improper for the reasons stated in the Commission's past Orders. No valid ground allows the Commission to distinguish or disregard its Orders in the 2005 ComEd rate case and in *Peoples Gas* and approve those proposals. To do so here would be arbitrary and capricious, as indicated in *Peoples Gas*, and reversible error.

b. AG/CUB and IIEC Proposals Plainly Violate the Commission's Rules

AG, CUB, and IIEC also make several arguments that the Commission's rules support their proposed adjustments. In particular: (1) they claim that the *pro forma* adjustments rule mandates that all known *pro forma* adjustments be made; and (2) the rule, when it says "changes ... in plant investment", can only mean "changes in net plant." *E.g.*, AG Init. Br. at 7-8, 10; IIEC Init. Br. at 7, *et seq.* They are wrong. As is demonstrated above, the Commission has already settled this issue. Moreover, their reading is inconsistent with the plain language of the rules as well as prior Commission Orders. They essentially ignore that their proposed adjustments would violate the Commission's test year rule (83 Ill. Adm. Code § 287.20) and test year principles by improperly moving the test year for the Depreciation Reserve into the future, as the Commission repeatedly has held. *E.g.*, Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 23:474-482. That is yet another reason the Commission should decline IIEC's invitation to disavow its prior decisions.

The claim that the Commission's rules mandate that all known *pro forma* adjustments be made is wrong. The rule does not say that and no Commission Order has ever so held. The rule provides that "a utility may propose *pro forma* adjustments ... for all known and measurable changes in the operating results of the test year. 83 Ill. Adm. Code § 287.40 (emphasis added). It does not say "must". In fact, when the Commission readopted the rule in 2003, after it already had faced the issue at hand, it expressly rejected a Staff proposal that the rule be amended to

require that all known *pro forma* adjustments be made. *Illinois Commerce Comm'n (Revision of Part 285 and Adoption of Parts 286 & 287)*, Docket No. 02-0509, Second Notice Order at 31-32. Nor do AG/CUB and IIEC adopt their own proposal. They did not propose all *pro forma* adjustments in the instant case. They did not, for example, propose to increase operating expenses in the revenue requirement based on 2007 actual results when those numbers became available.

The AG/CUB and IIEC claim that “changes ... in plant investment” can only mean “changes ... in net plant” is also wrong, for several reasons. If “plant investment” were intended to mean “net plant,” the Commission could have used those words. It did not. Nor did it change those words when it amended the rule in 2003, despite having faced the issue in the 2001 ComEd and IP rate cases. The Commission knows how to use the term “net plant” in its rules, as is evident from its use of the term when it adopted Schedule F-4 (83 Ill. Adm. Code § 285.6100) at the same time in 2003.

Moreover, it is entirely reasonable to read “changes ... in plant investment” to mean plant investment (capital expenditures) that occurred after the test year, less the accumulated depreciation associated with those post-test year capital additions (not with test year plant), as the Commission has repeatedly done. IIEC cites testimony of Staff witness Griffin, but that testimony shows that the AG/CUB and IIEC proposals should be rejected. Mr. Griffin in his rebuttal testimony explained why he does not believe that a Depreciation Reserve adjustment for test year plant should be adopted in this case. Griffin Reb., Staff Ex. 15.0 Corr., 5:99 – 6:116. Under cross-examination by IIEC, Mr. Griffin further testified that:

- Because ComEd proved that its first quarter and second quarter 2008 *pro forma* additions are known and measurable, the Depreciation Reserve for test year plant should not be

moved forward if those additions are approved, and that to do so would be inconsistent with the Commission's test year and *pro forma* adjustments rules and its prior Orders (Griffin, Tr. 674:2 - 675:14, 677:2-678:2).

- The term "plant investment" in the *pro forma* adjustments rule does not encompass post-test year accumulated depreciation associated with test year plant (Griffin, Tr. 6792-20; *see also id.* at 675:5 - 677:19 distinguishing test year plant from *pro forma* capital additions).
- A future test year works differently from an historical test year under the Commission's rules and Orders, but that is not inconsistent with his position (Griffin, Tr. 682:14 – 683:22).

IIEC serves up several other arguments for its proposed adjustment. They are each meritless.

- IIEC's arguments about the definition of net plant and the revenue requirement (IIEC Init. Br. at 7, 10, 12) assume that the term "plant investment" means "net plant" in the first place. Moreover, IIEC, like AG/CUB, does not propose to reflect all changes in the revenue requirement. IIEC has not reflected ComEd's actual operating expense increases in 2007, as noted earlier.
- IIEC notes that the rule refers to changes that affect ratepayers, and claims that ratepayers are only "affected" to the extent that the capital additions exceed offsetting changes in accumulated depreciation. IIEC Init. Br. at 7. The undisputed evidence is that, consistent with the Commission's rules and prior Orders, when calculating its Depreciation Reserve, ComEd started with the jurisdictional figure for the reserve as of the end of the test year, *i.e.*, as of December 31, 2006, and then made the adjustments needed to reflect the

impacts of its proposed adjustments to plant, including its *pro forma* adjustments for post-test year capital additions, incorporating the correct amount of accumulated depreciation associated with those additions. *E.g.*, Houtsma/Frank Dir., ComEd Ex. 7.0 Corr., 18:327-34, 34:660-35:683, 36:689-93; ComEd Ex. 7.1, Sched. B-1, p.1, l. 8, column (D), Sched. B-2, p.1, columns (B) and (C), Sched. B-2.1; ComEd Ex. 7.2, Work Papers WPB-2.1a, WPB-2.1b. AG/CUB's and IIEC's own witnesses, Messrs. Effron and Gorman, admitted that they do not challenge ComEd's calculation of the amounts to be added to the Depreciation Reserve for the *pro forma* capital additions; rather, they propose only to add post-test year depreciation expense related to test year plant to the Depreciation Reserve. *See, e.g.*, Effron Dir., AG/CUB Ex. 2.0, 7:152-157, 8:173-178; Gorman Dir. , IIEC Ex. 2.0 Corr., 57:1215-1219.¹⁸

- IIEC distorts ComEd witness McDonald's testimony, which in no way supports IIEC's position, much less suggests that ComEd's position somehow results in excessive *pro forma* capital additions or an inflated rate base. *See* IIEC Init. Br. at 22 (citing McDonald Tr. 1781 - 1782, 1785). Mr. McDonald testified that a future test year for 2009 would better match ComEd's costs of service because the costs are higher than what is being proposed in this case. McDonald, Tr. 1779 - 1985; *see also* McDonald Reb., ComEd Ex. 28.0, 2:35-4:87. IIEC's uncharacteristically reckless language, that using a future test year "would have precluded fabrication of the inflated rate base ComEd

¹⁸ IIEC cites Mr. Effron's statement at the evidentiary hearing of an irrelevant assertion he never made in his written testimony: that in no other State of which he is aware would the utility commission allow *pro forma* capital additions to be calculated in the manner that the Commission's Orders allow. IIEC Init. Br at 12-13, *citing* Effron, Tr. 599-600. Mr. Effron, needless to say, presented no citations, and he did not present the Commission with how other jurisdictions would make the calculation, nor the larger context of how they calculate revenue requirements with all of their differences from Illinois. Nonetheless, he agreed that it is a reasonable principle, as stated in *Peoples Gas*, to "bring certainty to a situation and settle expectations". Effron Tr. 601-602.

proposes ...” (IIEC Init. Br. at 22), is inconsistent with the uncontradicted data regarding ComEd’s investments and net plant increases discussed earlier. It also ignores that a future test year would have captured the post-test year increases in ComEd’s operating expenses that have not been included in the revenue requirement because this is an historical test year case. The implication that ComEd did not use a future test year because it would result in a lower revenue requirement is simply false.

- IIEC argues that Section 9-211 of the Act, 220 ILCS 5/9-211, and the doctrine of single-issue ratemaking somehow support its proposal (IIEC Init. Br. at 9, 20-23). IIEC notes that Section 9-211 permits inclusion in rate base of “only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.” However, IIEC overlooks that: (1) the vast majority of the *pro forma* capital additions already are in service (*e.g.*, Donnelly Reb., ComEd Ex. 21.0 Corr., 2:29-32); (2) the additions only encompass projects that will be in service by the end of the third quarter of 2008 (or only by the end of the second quarter, under the Staff/ComEd joint recommendations), and thus exclude ComEd’s capital expenditures made during this period on projects not expected to be in service by the third quarter of 2008; and (3) the rates being set in this case will not go into effect until October 2008. ComEd has submitted overwhelming evidence that the *pro forma* capital additions are prudent, reasonable in cost, and used and useful, as discussed in Sections IV.A and IV.C.1.a of its Initial Brief and this Reply Brief. ComEd has repeatedly refuted IIEC’s assertion that its interpretation is needed to avoid an inflated rate base. IIEC’s baseless assertion that its interpretation is needed to avoid an overstatement of the cost of capital is equally incorrect.

- IIEC’s argument that the Commission’s longstanding interpretation of its rules somehow amounts to single issue ratemaking (IIEC Init. Br. at 22-23) is wrong. This is a general rate case in which the Commission has an appropriate record regarding ComEd’s costs and revenues. Moreover, IIEC ignores the uncontradicted evidence of the post-test year increases in ComEd’s operating expenses that are not included in ComEd’s revenue requirement, and ComEd’s resulting under-recovery of its costs of service, noted earlier.

Finally, ComEd calls to the Commission’s attention to two additional facts that cut across each of the intervenors’ arguments and underscore that those arguments are at irreconcilable odds with the Commission’s rules.

- The AG/CUB and IIEC proposals to change the test year for the Depreciation Reserve violate the *pro forma* adjustment rule’s ban on adjustments based on “attrition or inflation”, as the Commission found in the 2005 rate case and in *Peoples Gas*. 83 Ill. Adm. Code § 287.40; Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 24:506-509, 26:540-542; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 15:329-333; ComEd Init. Br. at 33; ICC Docket No. 05-0597 (Order, July 26, 2006) at 13, 15; *Peoples Gas* Order at 14, 16-17. None of the AG, CUB, or IIEC Initial Briefs even mentions this point, apart from their incidental inclusion of the word “attrition” in quotations of the rule, much less offer any response to this fatal defect in their proposal.¹⁹
- AG/CUB and IIEC completely ignore that the *pro forma* adjustments rule as applied to post-test year capital additions in Illinois serves a critical function in reducing regulatory lag as to utilities such as ComEd that are making capital investments that lead to large

¹⁹ AG/CUB invoked (successfully) the rule’s ban on adjustments based on inflation in opposing a *pro forma* adjustment in *Peoples Gas*. See ICC Docket No. 07-0241/0242 (cons.) (Order, February 5, 2008) at 14, 39-40.

annual increases in net plant. *E.g.*, McDonald Reb., ComEd Ex. 28.0, 6:118 – 8:172, 9:184-191.

In sum, AG/CUB's and IIEC's proposed adjustments to the Depreciation Reserve violate the Commission's test year and *pro forma* adjustments rules. Even had the Commission in its own point Orders not repeatedly so held, approving those adjustments would be contrary to law. To overturn those decisions now so as to reach a different result for ComEd would be arbitrary and capricious and substantively erroneous as a matter of law.

3. Accumulated Deferred Income Taxes (ADIT)

AG/CUB persist in proposing that the ADIT balance be inflated by adding post-test year deferred income taxes, in the amount of \$88,297,000. AG Init. Br. at 11-12; CUB Init. Br. at 16. AG/CUB's arguments are incorrect, and their proposal is improper, for the reasons discussed in the preceding subsection of this Reply Brief. Moreover, they also are incorrect for the additional reason that, while they argue that net plant changes should be the basis of the calculation of *pro forma* capital additions, the definition of net plant does not include ADIT. *E.g.*, Griffin, Tr. 668:17 – 669:18, 677:10, 681:7-14. So, even under their own arguments, their proposed adjustment lacks merit. IIEC did not pursue its similar proposal in its Initial Brief. The proposed adjustments to ADIT are improper and should be rejected.

D. Rate Base (Total)

For the reasons discussed above and in Section IV of ComEd's Initial Brief, the evidence in the record supports approval of a rate base of \$6,752,566,000.²⁰

²⁰ This assumes that issues are resolved as recommended by ComEd and Staff. Otherwise, the Commission should approve a rate base of \$6,951,006,000. That is the amount supported by the evidence in the record without ComEd's limited waivers in the Staff/ComEd joint recommendations.

V. **OPERATING EXPENSES**

A. **Overview**

ComEd established its operating expenses, as discussed in Section V of its Initial Brief and this Reply Brief. Only a relatively small number of contested issues remain concerning operating expenses. These include proposed disallowances of prudent and reasonable incentive compensation, A&G, and rate case expenses. ComEd proved these expenses. The proposed disallowances are incorrect and they are inconsistent with the Order in ComEd's 2005 rate case. They, and the remaining proposed adjustments, should be rejected.

B. **Uncontested Issues**

1. **Storm Expenses**

This issue remains uncontested. *See* Staff Init. Br. at 30.

2. **Rate Case Expenses**

a. **Rate Case Expenses of the Instant Case**

This issue remains uncontested. *See* Staff Init. Br. at 30.

b. **Original Cost Audit Legal Expenses**

This issue remains uncontested. *See* Staff Init. Br. at 31-32.

3. **Advertising**

This issue remains uncontested. *See* Staff Init. Br. at 32.

4. **Charitable Contributions**

This issue remains uncontested. *See* Staff Init. Br. at 32-33.

5. **Lobbying**

This issue remains uncontested. *See* Staff Init. Br. at 33.

6. “Non-recurring” Expenses (AT&T Lease)

This issue remains uncontested. *See* Staff Init. Br. at 33-34.

7. Derivative Impact of Capitalized Incentive Compensation Not Allowed in 2005 Rate Case (See IV.B.1.b.) (Uncontested)

This issue remains uncontested.

C. Contested Issues

1. Incentive Compensation Cost and Expenses

ComEd, in both its testimony and Initial Brief (at 3, 5-6, 7, 41-49), candidly discussed and applied the standards established in the Commission’s past Orders regarding incentive compensation. Staff and IIEC have done that in some respects. However, in others, they remain far off the mark. The AG and CUB have not fairly addressed the Commission’s past orders. ComEd’s proposal in this case includes incentive compensation, the majority of which is expressly allowed under established Commission decisions, including ComEd’s last rate case order. There is no basis to disallow these costs. The remainder also uses metrics that the evidence shows should be accepted under the principles of those decisions.

A large part of the challenged incentive compensation costs are incurred under the ComEd Annual Incentive Plan’s (the “AIP”) Total Cost goal, *i.e.*, its metric based on controlling capital expenditures and operating expenses. Staff challenges one-half of the amounts incurred under the Total Cost goal. This amounts to a proposed disallowance of \$3,018,000 of test year capitalized costs, \$4,999,000 of test year operating expenses, and \$810,000 of operating expenses in ComEd’s *pro forma* adjustment, for a total revenue requirement impact of \$6,154,000. *E.g.*, ComEd Init. Br. at 43; Staff Init. Br. at 34. IIEC also proposes to disallow 50% of these costs and expenses. IIEC Init. Br. at 25-26, *et seq.* AG/CUB proposes an arbitrary

across the board reduction in incentive compensation costs and expenses, and complete disallowance of certain amounts, as discussed in Sections V.C.1.c, V.C.1.d, and V.C.1.e, below.

The costs ComEd incurs under the Total Cost goal simply should not be an issue in this case. Staff, the AG, CUB, and IIEC all take the position that the Commission's past Orders establish the standard that incentive compensation costs and expenses should be approved if they involve savings or other tangible benefits for customers. *E.g.*, Hathhorn Dir., Staff Ex. 1.0, 20:476–22:518; AG Init. Br. at 14; CUB Init. Br. at 8-9; IIEC Init. Br. at 27-28. The Commission has expressly found that the Total Cost goal does just that. In ComEd's own 2005 rate case, the Commission approved amounts incurred under the AIP's Total Cost goal under that standard, finding that it benefited customers and expressly rejecting Staff's argument that shareholders also could benefit from this metric. Docket No. 05-0597, Order at 95-97. No party has identified any new or credible reason for disallowing any amount incurred under the AIP's Total Cost goal, as discussed further below.

Nor should amounts incurred under plan metrics tied to the reliability metrics SAIFI and CAIDI be at issue. Staff, recognizing this, now supports full recovery of such amounts. However, IIEC and AG/CUB still propose to disallow portions of those costs and expenses, as discussed in Sections V.C.1.c, V.C.1.d., and V.C.1.e, below. The Commission, in ComEd's 2005 and 2001 rate cases, approved full recovery of amounts incurred under such reliability metrics, and these proposed disallowances are simply contrary to the established standards for recovery of these costs.

The remaining challenged amounts were not directly ruled upon in ComEd's 2005 rate case, although they include amounts incurred under the AIP's ComEd net income metric, which ComEd substituted for the former Exelon earning per share ("EPS") metric in light of the Order

in that case. ComEd Init. Br. at 43. Staff's and Intervenors' challenges to the amounts incurred under the AIP's net income metric, and their remaining challenges to amounts incurred under other metrics, should not be adopted.²¹ Indeed, even IIEC agrees that customer benefits under the AIP's net income metric warrant allowing 50% of the amounts incurred under that metric. IIEC Init. Br. at 25-26. The amounts that Staff challenges under the AIP's net income metric are \$333,000 of capitalized test year costs, \$541,000 of test year operating expenses, and \$88,000 of operating expenses in ComEd's *pro forma* adjustment, while IIEC opposes only half of those amounts. ComEd Init. Br. at 45; Staff Init. Br. at 34; IIEC Init. Br. at 25-26, *et seq.*

In the following sections, ComEd applies these principles to the particular incentive plan components at issue.

a. The AIP's Total Cost Goal

The amounts challenged by Staff and IIEC under the AIP's Total Cost goal – \$3,018,000 of test year capitalized costs, \$4,999,000 of test year operating expenses, and \$810,000 of operating expenses in ComEd's *pro forma* adjustment, with a total revenue requirement impact of \$6,154,000 – should not be an issue in this case, as discussed above. The arguments for disallowing those costs lack merit and have been rejected by the Commission.

Staff argues that any contention that its proposed disallowance is contrary to the Order in the 2005 rate case is “superficial and erroneous”. Staff Init. Br. at 37. Staff's position, however, is indefensible. Staff's argument remains that shareholders also do (or could) benefit from the Total Cost goal, just like Staff argued in the 2005 rate case. Staff, however, says that in that case the Commission did not see Staff's current proposal to disallow only half, rather than all, of the

²¹ ComEd presented uncontradicted evidence that its total compensation package, including these items of incentive compensation, is prudent and reasonable in amount, is necessary to help attract and maintain a sufficient, qualified, and motivated work force. ComEd Init. Br. at 41.

costs incurred under that goal. *Id.* at 37-38. That difference is no distinction. Staff ignores that regardless of the percentage amount of the disallowance sought, the Commission expressly rejected Staff's premise that concurrent shareholder benefits warranted disallowing those amounts, finding:

When it comes to the other three components of the incentive plan, which constitute the other fifty percent of the plan's total funding, we believe it is hard to ignore the tangible benefits to ratepayers that result from meeting those operational goals. ****

Focusing on the funding measure that rewards employees for reducing O&M and capital expenses, the Commission finds that such funding measure meets the Commission's standard of reducing expenses and creating greater efficiencies in operations. Lowering O&M expenses, all else being equal, has the obvious effect of reducing the expenses to be recovered in future rate cases. While Staff argues that shareholders could also benefit from reduced O&M expenses through a potential concurrent increase in earnings, we note that the incentive compensation payments are linked directly to reduced O&M costs and thus an increase in earnings will not trigger any incentive compensation payments. In other words, increased earnings is a potential result, but not a necessary result of reduced O&M expenses. In addition, when we compare the incentive compensation costs allowed to be recovered in the company's previous rate case to the costs we allow here, we note that there was an additional financial trigger for the operational goals in the former. We do not have such a financial trigger here and thus there exists an even stronger link between incentive payments and the meeting of operational targets than in the previous rate case.

Commonwealth Edison Co., Docket No. 05-0597, Order at 96-97.

The ComEd decision is not alone. The Commission also rejected Staff's attack on a similar metric in the *Peoples Gas* Order (at 66), and the Commission has also found that similar metrics benefit customers in ComEd's 2001 rate case and other rate cases. ComEd Init. Br. at 44. While Staff twice states that the Commission only found "some benefits" to customers (Staff Init. Br. at 37), implying that the Commission's findings were tentative or limited, actual Commission findings show that not to be true. The Commission's Order in ComEd's 2005 case, for example, could not be more clear that controlling capital expenditures and operating expenses

benefits customers. No party has explained how their position can be squared with the Commission's express findings above, or in the other cases ComEd cites.

Moreover, the evidence in this case shows that the Total Cost goal in fact benefits customers by controlling and reducing costs and expenses. *E.g.*, McDonald Reb., ComEd Ex. 28.0, 13:284 – 14:290, 14:301 – 15:318; McDonald Sur., ComEd Ex. 41.0, 7:134-139. The Total Cost metric, for example, helps keep the costs related to achieving CAID and SAIFI goals in check by providing checks and balances. McDonald Reb., ComEd Ex. 28.0, 13:286 – 14:288; McDonald Sur., ComEd Ex. 41.0, 6:133 – 7:139. In contrast, no party has submitted evidence that the metric does not benefit customers. Staff and IIEC limited their proposed disallowances to 50% precisely because their witnesses agreed that the Total Cost goal benefits customers. *E.g.*, Hathhorn Dir., Staff Ex. 1.0, 13:275-284; Gorman Dir., IIEC Ex. 2.0 Corr., 61:1310-62:1322.

The remaining arguments for this disallowance also lack merit. IIEC attempts to equate the Total Cost goal with the former Exelon EPS metric (IIEC Init Br. at 30-31), but that simply is not the case. The Order in the 2005 rate case, which IIEC cites here, expressly distinguished the two, allowing the amounts incurred under the Total Cost goal and disallowing the amounts incurred under the Exelon EPS metric. ICC Docket No. 05-0597, Order at 96-97. IIEC also points to Staff's testimony that reducing capital expenditures and operating expenses only benefits customers to the extent reflected in rates. IIEC Init. Br. at 30. The evidence is uncontradicted, however, that the AIP's Total Cost goal was before the Commission in the last rate case and remains in the plan (at an increased percentage level, because the Total Cost goal was increased to replace the Exelon EPS metric for most employees (McDonald Dir., ComEd Ex. 9.0, 24:482-487; *see also* McDonald Reb., ComEd Ex. 28.0, 18:377-382)).

In sum, ComEd has worked hard to structure its business around the directives the Commission has provided in past cases. The evidence is uncontradicted that after the Order in the 2005 rate case, ComEd immediately moved to conform its incentive compensation plans to the Order. It would be both unlawful (arbitrary and capricious) and unfair for the Commission to retroactively change the standards now. The Commission should approve all amounts incurred under the Total Cost goal.

b. The AIP's Net Income Metric

Staff proposes to disallow all amounts incurred under the AIP's net income metric -- \$333,000 of capitalized test year costs and \$541,000 of test year operating expenses plus another \$88,000 of operating expenses in ComEd's *pro forma* adjustment, with a revenue requirement impact of \$667,000 – while IIEC proposes to disallow 50% of those amounts. Staff Init. Br. at 34-37; IIEC Init. Br. at 25-26, 30. Staff, CUB, and IIEC all argue that ComEd's net income is a financial metric, suggesting it is similar to the former Exelon EPS metric, but IIEC acknowledges that the net income metric also benefits customers and, therefore, IIEC proposes only a 50% disallowance.²²

The net income metric benefits customers in multiple respects, including properly balancing incentives to promote reliability and safety with incentives to control expenses while maintaining ComEd's financial health and stability so that it can continue to make needed distribution system expenditures and provide reliable service. ComEd Init. Br. at 45. The Commission should reject the proposals to disallow amounts incurred under the AIP's net

²² ComEd acknowledges that in the 2004 Nicor Gas rate case, the Commission did not allow incentive compensation tied to a net income metric, but ComEd also notes that that Order's findings are based on the evidence in that Docket, including findings that the utility's evidence was insufficient. Docket No. 04-0779, Order at 44-46. Here, ComEd has submitted strong evidence of customer benefits, and IIEC has submitted evidence supporting 50% recovery.

income metric. In the alternative, given the strong evidence of customer benefits, the Commission should allow 50% of those amounts, as proposed by IIEC.

c. AG/CUB's 50% Theory

ComEd's Initial Brief showed that AG/CUB's arbitrary proposal to disallow 50% of all costs and expenses incurred under the AIP is not based on the facts, is inconsistent with applicable Commission decisions, and lacks merit. ComEd Init. Br. at 46. Nothing in the AG's or CUB's Initial Briefs shows the contrary. CUB's speculation that, in the future, ComEd's incentive plans might change or that the targets might not be met (CUB Init. Br. at 11-13) is just that, speculation. Speculation that future costs may change has never been a basis to disallow expenses proven during a rate case. The evidence in the record, as well as the Orders in ComEd's 2005 and 2001 rate cases, shows their proposal to be baseless and unlawful.

d. The LTIP

Staff continues to propose to disallow portions of the Long-Term Incentive Plan ("LTIP") costs other than the amounts paid out under the SAIFI and CAIDI reliability metrics, while IIEC seems to continue to propose 100% disallowance of all LTIP costs despite agreeing that ComEd should be allowed 100% cost recovery under the AIP's SAIFI and CAIDI metrics. Staff Init. Br. at 39-41; IIEC Init. Br. at 26, 29-30; *compare* IIEC Init. Br. at 25. Staff proposes to disallow \$1,022,000 of capitalized costs and \$6,741,000 of operating expenses.²³ Staff Init. Br. at 34. The AG also appears to still advocate 100% disallowance of stock-based compensation related to the LTIP. AG Init. Br. at 14, 15. IIEC previously took that position but did not advance it in its Initial Brief.

²³ Staff's figure for its proposed disallowance includes the derivative financial impacts, which is why it differs from ComEd's statement of Staff's figure here. *Compare* ComEd Init. Br. at 47; *with* Staff Init. Br. at 34.

No basis supports disallowing the amounts paid out under the LTIP's SAIFI and CAIDI metrics, which include \$232,000 of capitalized costs and \$978,000 of operating expenses. Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 42:882-888. The benefits to customers of reliability metrics are obvious, as recognized by Staff's and IIEC's witnesses (Hathorn Reb., Staff Ex. 14.0, 12:277-281; IIEC Init. Br. at 25), and the Commission has recognized those benefits as warranting full cost recovery of amounts incurred thereunder in ComEd's last two rate cases. *E.g.*, McDonald Reb., ComEd Ex. 28.0, 13:267-271; Order in ICC Docket No. 05-0597, p. 96. The proponents of disallowance have once again not squared their position with the applicable Commission Orders.

ComEd showed in detail that the other LTIP metrics also benefit customers, in many respects. ComEd Init. Br. at 46-48. Staff's, the AG's, and IIEC's arguments consist of a mixture of claims that customers do not benefit from specific components of the other metrics and claims that even though customers do benefit they are not benefits that "count" under the Commission's standards. ComEd, however, has proven how customers benefit. Moreover, the Commission should not disregard real benefits on the theory that they do not "count," especially given that the goals include those supported by Commission's Orders and disallowance of the costs are inconsistent with ComEd's right to recover its prudent and reasonable costs. ComEd has also already refuted the AG's claim that payments made in the form of stock compensation should be disallowed regardless of whether they are paid under a metric that benefits customers. ComEd Init. Br. at 48. The AG's Initial Brief (at 15) provides no additional support for its position.

In sum, there can be no reasonable dispute over the LTIP costs incurred under the SAIFI and CAIDI metrics (\$232,000 of capitalized costs and \$978,000 of operating expenses). As this

section has demonstrated, however, the Commission should also allow all other amounts incurred under the LTIP.

e. **AG/CUB's Proposal to Reject ComEd's Pro Forma Adjustment**

AG/CUB's argument to disallow ComEd's *pro forma* adjustment to update its incentive compensation costs related to 2007 targets applies no recognized Commission standard and overlooks that customers did benefit in 2007 from the achievement of operational metrics, such as those associated with CAIDI and SAIFI. ComEd Init. Br. at 48. AG/CUB's proposal, instead, speculates that ComEd could "turn off" its incentive compensation program and reduce its costs between test years and yet still achieve the same results in terms of controlling costs and expenses, maintaining and improving reliability, etc. That unreasonable premise has no basis in the evidence. The AG (Init. Br. at 14-15) fails to refute that a competitive level of pay is necessary and, in essence, asks the Commission to ignore that ComEd did respond to the Commission's direction in the last rate case. AG/CUB's proposal should be rejected.

f. **Conclusion**

In summary, ComEd's incentive compensation costs and expenses should be allowed in full, under the well-established legal principle of allowing recovery of prudent and reasonable costs and expenses. In the alternative, the amounts should be approved in full as to the AIP Total Cost goal and the LTIP SAIFI/CAIDI metrics plus approved in a reduced amount (*i.e.*, 50%) as to the AIP net income metric, for the reasons stated above and in Section V.C.1 of ComEd's Initial Brief.

2. **Uncollectibles Expenses (Derivative Adjustment)**

All proposed adjustments to uncollectibles expenses are derivative impacts of one or more other proposed adjustments elsewhere. *See* ComEd Init. Br. at 49.

3. Merger Expenses

The AG incorrectly seeks to disallow \$2.546 million in non-incremental salary and wage expenses for employees who, during 2006, not only performed all of their usual and ordinary delivery service functions for ComEd but also performed additional services in connection with the abandoned Exelon-PSEG merger. AG Init. Br. at 15-16. The AG's proposal has no merit. ComEd Init. Br. at 49-50. Staff, which once took the same position, no longer does so after reviewing the facts and evidence that ComEd presented. Staff Init. Br. at 42.

The AG fails to articulate any rational basis for its proposed disallowance. It argues first that "it is unclear how much time these employees will be spent [sic] performing utility related duties," and says that if these employees performed "merger work for free," no costs should have been assigned to that work. AG Init. Br. at 16. This ignores the reality that ComEd has explained time and again: (1) employees that worked on the merger are salaried employees who were still responsible for their normal utility duties and completed their merger related duties by effectively working unpaid overtime; (2) ComEd does not pay salaried workers for overtime, so there is no sound business reason to make them record the total number of hours they worked; and (3) ComEd wanted to record hours devoted to the merger. Houtsma/Frank Reb., ComEd Ex.25.0 Corr., 54:1116–56:1174; Houtsma/Frank Sur., ComEd Ex. 40.0 Corr., 24:538–25:557. Thus, hours that would have otherwise been assigned to normal utility duties that were still being completed, were instead assigned to the merger.²⁴

Unlike Staff, the AG fails to comprehend that the amounts ComEd seeks to recover here were spent to pay salaried employees who provided full-time service to the utility in furtherance

²⁴ The fact that employees spent a portion of their normal 40 hour work week on the merger (and recorded that merger related time as required) did not excuse them from completing 100% of their regular delivery service related job – even if that meant more than a 40 hour work week (for which they were not paid overtime).

of its distribution related functions. *Id.* Failure to allow ComEd to recover this \$2.546 million would be an unlawful disallowance of normal and reasonable employee costs actually incurred for employees performing regular distribution related duties.

In 2006, ComEd's customers got a full day's work for a full day's pay from those employees whose salary and wage expense are included in the revenue requirement, and which the AG seeks to disallow in part. Moreover, these test year expenses are fully representative of the services that those employees will perform once the rates that are the subject of this case go into effect. *Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 56:1171-73.* As such, they are legitimate and allowable utility expenses and the AG's proposed adjustment lopping off a part of those expenses should be rejected.

4. Administrative and General (A&G) Expenses

a. Exelon Way Severance Amortization

The AG continues to argue that no regulatory asset for Exelon Way severance costs was created by the Commission's Order in Docket No. 05-0597, and therefore it would be inappropriate to include in ComEd's revenue requirement \$18.791 million for such costs. The AG misstates the nature of ComEd's request in Docket No. 05-0597, and misinterprets what the Commission allowed ComEd to do. It is obvious from the Order in that case that the Commission approved recovery of the full amount of ComEd's Exelon Way severance costs, not just the 2004 test year amount. As the AG mentions, Staff witness Hathhorn agrees with ComEd's interpretation of the Order in the 2005 case. AG Init. Br. at 17, *citing* Hathhorn Reb., Staff Ex. 14.0, at 17-18. Ms. Hathhorn specifically testified that Mr. Efron's proposed adjustment should not be adopted. Hathhorn Reb., Staff Ex. 14.0, 18:399-401.

\$18.8 million of Exelon Way severance expenses was allowed by the Order in Docket No. 05-0597, as the AG correctly notes. However, contrary to the AG's claim, this sum did not

simply reflect the actual costs incurred in the test year. Instead, ComEd sought recovery of the severance expenses consistent with the authority of Section 285.3215 of Part 285, which provides for the recovery of “initial costs” of cost savings programs anticipated to result in annual jurisdictional savings of over \$1 million. The Commission fully understood that ComEd was seeking to amortize the full amount of these costs: “ComEd’s proposed operating expenses include an appropriate level of severance expense, including an amortized level of the Exelon Way severance expenses.” Docket No. 05-0597, Order at 86 (emphasis added). Further, the Commission cited Section 285.3215 in that Order: “[T]he record establishes that ComEd properly seeks recovery of its initial severance costs for a program expected to produce hundreds of millions of dollars in savings over the life of these rates. Mr. Effron’s proposed adjustment would deny ComEd any recovery of that cost, which removes the incentive created by Section 285.3215 to initiate such programs.” Docket No. 05-0597, Order at 90. Had ComEd been seeking only to recover its 2004 test year costs for the Exelon Way Severance program, ComEd would have had no need to cite, and the Commission would have had no need to rely upon, Section 285.3215.

It was clear in Docket No. 05-0597 that ComEd sought recovery of the full amount of the “initial” Exelon Way severance costs. ComEd Ex. 40.03; Order in Docket No. 05-0597, p. 86. The Commission agreed with ComEd. The AG’s after-the-fact attempt to alter that result should be rejected, as should Mr. Effron’s proposed adjustment.

b. Accounts 920-923

The AG argues that the actual expenses recorded in FERC Accounts 920-923 should be reduced by \$12.7 million²⁵ based on the claim that the increase in these accounts exceeded the general inflation rate by this amount and was not, in the AG's view, "satisfactorily explained."²⁶ AG Init. Br. at 19. The AG is wrong. The AG also says that the Commission did not focus on those particular accounts in ComEd's last rate case, Docket No. 05-0597, and thus the Commission did not actually reject this inflation approach in that case. The AG badly mischaracterizes what the Commission did in fact do in that case.

The Commission, in its July 2006 Order in Docket No. 05-0597, limited ComEd's overall increase in A&G expense to an inflation adjustment on the grounds that ComEd had not provided, in that case, a satisfactory explanation for the above-inflation rate increases. However, the AG completely fails to point out that on rehearing, ComEd supplied substantial additional information describing the reasons for the increases in its A&G costs, and the Commission in its Order on Rehearing accepted that explanation and approved most of ComEd's actual A&G costs for recovery. Order on Rehearing at 49-51. Staff agrees that the adjustments being proposed by the AG are not consistent with the Commission's Order on Rehearing. Staff Init. Br. at 43.

In presenting its direct case in this docket, ComEd used the Commission's action on Rehearing in Docket No. 05-0597 as the template to follow. A review of the evidence presented by ComEd in its original filing in this case reveals that ComEd presented here at least as much information, in fact more, as it presented on rehearing in the 2005 case. In particular:

²⁵ The AG's initial brief at 19 describes this as \$12.4 million. However, it appears the actual proposed disallowance is \$12,680,00 or \$12.7 million. See AG initial brief at 20, along with AG Ex. 5.1 Schedule C-2.1.

²⁶ Mr. Effron concedes that ComEd explained the increase, but complains that it had not done so to his satisfaction. Effron, Tr. 571:8-11. Unfortunately, neither ComEd nor the Commission has any way of knowing what subjective standard Mr. Effron applied in this regard.

- An independent expert, Mr. Flaherty (ComEd Ex. 8.0), reviewed and presented a voluminous Booz Allen Hamilton (“BAH”) study of ComEd’s A&G expenses (ComEd Ex. 8.2). This is described in detail in ComEd’s Initial Brief (at 53).²⁷
- In direct testimony, Mses. Houtsma and Frank broke down the “drivers” of the increase in revenue requirements from the Docket No. 05-0597 Rehearing Order. That breakdown showed that about \$99 million of the increase in ComEd’s revenue requirement was due to increases in A&G costs. Houtsma/Frank Dir., ComEd Ex. 7.0 Corr., 47 (Table).
- The Houtsma/Frank direct testimony further explained the factors that led to the increase in A&G expense, breaking down the \$99 million increase into individual components. *Id.* at 47:916-51:1004; ComEd Ex. 7.3 Corr.
- The Houtsma/Frank testimony showed the \$29.2 million that resulted from increased Exelon Business Services Company charges, broken down as follows:

Costs from EBSC increased jurisdictional A&G expenses, primarily reflecting higher costs for Information Technology (\$11.6 million) and Energy Delivery Shared Services (\$5.9 million). Additionally, higher Executive Service charges (\$4.3 million), higher Finance costs (\$3.0 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.

Id. at 49:957-64.

²⁷ The BAH report was an evaluation of ComEd’s total A&G expenses, before adjusting for ratemaking and *pro forma* adjustments, in order to appropriately benchmark and market test those costs. This is in keeping with the Commission’s Order in Docket No. 05-0597. See Houtsma/Frank Dir., ComEd Ex. 7.0 Corr., 30 (Table).

- Other components of the A&G expense increase were explained in equal detail. One of the largest elements – \$19.8 million for Rental Expense – was simply the result of an accounting reclassification that had no effect on the overall revenue requirement. *Id.*, 48:924-34.

The level of detail presented by ComEd in its direct testimony was more than equivalent to the level of detail that ComEd presented on rehearing in Docket No. 05-0597. In her testimony on rehearing in that case, Ms. Houtsma presented a table comparing the increases in A&G costs approved in ComEd’s prior rate case (Docket No. 01-0423, with a 2000 test year) with the 2004 test year in Docket No. 05-0597. *See* Docket No. 05-0597, Order on Rehearing at 30-31, *et seq.* In addition, the BAH report, which AG/CUB failed to address, presents an unprecedented level of detail regarding ComEd’s total A&G costs. Finally, in discovery and in rebuttal testimony, ComEd described the specific factors (including charitable contributions, facilities relocation, information technology costs, and training) that increased the three A&G Accounts that Mr. Effron claims have not been explained. *E.g.*, Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 58:1217 – 59:1229; *see also* Effron. Tr. 576:6 – 579:19 and ComEd Cross Ex. 3.

By seeking a disallowance on the grounds that ComEd simply did not “sufficiently explain” (that is, to his satisfaction) the increases, Mr. Effron overlooks that the explanation of the increase ComEd provided was more than compliant with the level of detail the Commission had found sufficient only nine months before ComEd filed this case. Under well-established law, once the utility presents its *prima facie* case of the costs needed to provide service, the burden of going forward with the evidence shifts to other parties to show that the costs are unreasonable because of inefficiency or bad faith. *Illinois Bell Tel. Co. v. Illinois Commerce*

Comm'n, 372 Ill.App.3d 769, 776 (3rd Dist. 2002); *City of Chicago v. Cook County*, 133 Ill.App.3d 435, 442-43 (1st Dist. 1985).

Here, it is notable that Mr. Effron has never identified any single expenditure in any of the Accounts 920-923 that he identified as perhaps imprudent or excessive. Having received a number of data request responses on the subject, Mr. Effron said nothing further about Accounts 920-923 in his rebuttal testimony. Effron, Tr. 579:20 - 580:3; ComEd Cross Ex. 3. In fact, Mr. Effron has affirmatively testified that he did not identify any costs that he was challenging on either “prudence” or “reasonableness” grounds. Effron, Tr. 574:18 - 575:2; 576:1-5.

In sum, ComEd provided unprecedented levels of detail on its A&G costs, and was not required to do more. Mr. Effron’s proposed adjustment lack support and should be rejected.

c. Rate Case Expenses

Despite the full evidentiary record on these issues, the AG continues to oppose recovery by ComEd of three separate elements of rate case expense: (1) expenses from the 2005 rate case for which the Commission in that case has already allowed recovery; (2) 2006 test year expenses from the 2005 rate case incurred in the 2006 test year that were not allowed by the Order in that case because they were estimated at the time the evidentiary record closed in that case; and (3) 2006 test year expenses incurred in connection with the rehearing in the 2005 rate case. Staff opposes recovery only of costs in the second category.

i. 2005 Rate Case Expenses Amortization

The AG complains that if ComEd is allowed to recover these expenses, it will be recovering portions of two sets of rate case expenses, *i.e.*, from this docket and the unrecovered portion of the approved costs from Docket No. 05-0597. AG Init. Br. at 20-21. That is no basis

to object to the recovery of appropriate costs. Tellingly, the AG does not and cannot identify why recovery of both types of expense goes against Commission rules or established ratemaking principles. Moreover, in Docket No. 05-0597, the Commission specifically approved recovery of ComEd's approved rate case expenses over an amortization period that has not yet ended. To disallow these costs now goes against the Commission's order in that case. Moreover, unless both of these expenses are recovered in the revenue requirement, ComEd will be unlawfully denied the opportunity to recover prudently-incurred costs.

The AG also argues that unrecovered costs of Docket No. 05-0597 should be disallowed because of a hypothetical chance that ComEd might over-recover these expenses. AG Init. Br. at 21. All rates are based on what is known as of the time they are set. It is illogical and unlawful to claim that the chance of over-recovery is grounds for building in rates certain under-recovery of previously approved expenses. *See* ComEd Ex. 7.1, Sched. C-2.15; ComEd Ex. 7.2, Work Paper WPC-2.15. Moreover, this argument ignores that the Commission does not allow the utility to recover carrying charges on rate case expenses, even though recovery is spread over a multi-year period. ComEd Init. Br. at 55, n. 34. This further dims any risk of over-recovery and underscores how unfair further disallowances would be.

Finally, once again, the AG overlooks prior Commission practice. The Commission approved a similar approach in Docket No. 01-0423. ComEd Init. Br. at 55-56. Staff does not join the AG's proposed disallowance. The AG's proposal should be rejected.

ii. 2005 Rate Case Expenses in the 2006 Test Year

Both Staff and the AG oppose recovery of additional expenses that were incurred in connection with the 2005 rate case but that were not specifically considered by the Commission in that case. *See* Staff Init. Br. at 43-46; AG Init. Br. at 21-22. These are actual expenses that, as

of the time that the record closed in the 2005 rate case, were still estimated, and thus were incurred too late in the proceeding to be considered “actual costs” in that case. ComEd Init. Br. at 57-58.²⁸

If this disallowance is accepted, ComEd faces a Catch-22 that will unlawfully deny it the ability to recover reasonable and prudent costs. In ComEd’s last case, some expenses were still estimated at the time the record closed. ComEd was unable to recover the expenses there because the Commission was not certain what the final expenses would actually be. If, in the next case, once the expenses have actually been incurred, they are again excluded, this time on the grounds that ComEd is “too late,” the result is to unfairly prevent these costs from ever being recovered, no matter how prudent and reasonable.

ComEd is not, contrary to the assertion of the AG, seeking to “relitigate” this or any issue. AG Init. Br. at 21. Nor is ComEd attempting to “true up” its prior rate case expenses, as Staff suggests. Staff Init. Br at 44. ComEd is simply requesting that costs that the Commission neither approved nor denied in Docket No. 05-0597, and that have been shown to be prudent and reasonable test year costs, be recoverable in this case. Both the Staff and the AG positions should be rejected and recovery allowed as proposed by ComEd.

iii. 2005 Rate Case Rehearing Expenses

The AG attempts to combine the costs of ComEd’s rehearing in Docket No. 05-0597 with other costs of that case, despite that they clearly deserve to be evaluated on their own merits. *See* AG Init. Br. at 20-22. Significantly, Staff does not propose to disallow these costs. The AG’s disallowance should be rejected.

²⁸ In that case, ComEd provided estimates of anticipated rate case expenses, but the Commission found that, because certain of these expenses were estimated, ComEd had not fully substantiated the amounts. Docket No. 05-0597, Order as 45-47.

ComEd's costs of rehearing in the last case could not have been estimated at the time that ComEd calculated its revenue requirement in that case. Houtsma/Frank Reb., ComEd Ex. 25.0 Corr., 63:1315-28. In fact, it would have been inappropriate for ComEd to assume when it filed that case that specific costs for rehearing would have been incurred more than a full year later. Moreover, these costs were not considered by the Commission in Docket 05-0597. Thus, as with the costs in the preceding subsection, ComEd is not seeking to relitigate something that was already decided, or asking the Commission to decide in retrospect how it would have treated those costs had they been presented in Docket No. 05-0597.

The costs of rehearing are now fully "substantiated." They have not been challenged as either imprudent or unreasonable in amount, and occurred during the test year of the instant case. It would be improper to disallow those costs. Recovery of the \$2,178,432 in rehearing expenses over the three year amortization period should be allowed by the Commission.

5. New Business Revenue Credit

The AG claims that Mr. Effron's use of 2007 growth data is appropriate because whether or not that growth is typical, it is what actually happened. AG Init. Br. at 22. Setting aside for a moment that Mr. Effron's chose to use data that is not typical, it is also clear that at least for the purpose for which the data is used it does not represent what actually happened. For purposes of calculating the new business revenue credit, customer growth is measured so that revenues from new customers may be offset against the *pro forma* capital additions, *i.e.*, these are revenues produced by the new plant installations. The customer growth Mr. Effron cites, however, is a combination of growth by existing customers (those who moved from a small customer class to a large customer class) in addition to customers new to the system. ComEd's analysis, set forth in its Initial Brief (at 60), was identified as covering only truly new customers. That is the growth

that should be used in the new business revenue analysis. Mr. Effron's suggestion that the growth he used is actual is only literally correct, and misses the point of the new business revenue credit adjustment. His adjustment should be rejected.

6. Depreciation and Amortization Expenses (Derivative and Direct Adjustments)

See ComEd Init. Br. at 61. No other party addressed this subject.

7. Taxes Other Than Income Taxes (Derivative Adjustments)

See ComEd Init. Br. at 61. No other party addressed this subject.

8. Income Taxes (Derivative Adjustments)

See ComEd Init. Br. at 61-62. No other party addressed this subject.

D. Operating Expenses (Total)

For the reasons discussed in the preceding subsections of Section V and in Section V of ComEd's Initial Brief, the evidence in the record, including the Staff/ComEd recommendations, should lead to the approval of operating expenses amounting to \$ 1,552,251,000 (including income taxes of \$208,475,000).²⁹

VI. RATE OF RETURN

A. Capital Structure (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 46.

B. Cost of Long-Term Debt (Uncontested)

This issue remains uncontested. *See* Staff Init. Br. at 47.

²⁹ Otherwise, the Commission should approve operating expenses of \$1,569,956,000 (including income taxes of \$214,815,000). That is the amount supported by the evidence in the record without ComEd's limited waivers in the Staff/ComEd joint recommendations.

C. Cost of Common Equity

In its Initial Brief, ComEd showed that a 10.75% cost of equity is supported by the evidence. Moreover, ComEd explained that the difference between Staff's cost of equity analysis and ComEd's are minor when updated inputs are considered. Using updated data is critical in this case because the evidence also shows that costs of capital are rising. Hadaway Sur., ComEd Ex. 42.0, 1:20-4:47; Hadaway Reb., ComEd Ex. 29.0, 4:76-6:118. If Staff's methodology is revised solely to use updated data, it results in a 10.65% cost of equity, only ten basis points different from ComEd's recommendation. Hadaway Sur., ComEd Ex. 42.0, 5:64-66. IIEC makes no attempt at all to update their analysis or conclusion. If the Commission concludes that Staff's analysis is preferable to ComEd's, it should approve a 10.65% cost of equity for ComEd.

Staff's brief does not discuss the critical importance of using current data in this case, nor disputes that it would be arbitrary and fundamentally unfair to ComEd to award it a suppressed return by ignoring newer data. Nor does Staff's brief discuss the 10.68% cost of equity Staff recommended for the Ameren utilities. Hadaway Sur., ComEd Ex. 42.0, 5:52-57. Although Ameren and ComEd are different companies with different risks, the record here shows that there is no reason why Ameren should be awarded a higher cost of equity than ComEd, which is the anomalous result of ignoring newer data. Hadaway Sur., ComEd Ex. 42.0, 6:69-71. Yet, Staff continues to propose only the 10.3% cost of equity that results from its analysis when out-of-date information is used. The Commission should not approve an outdated 10.3% cost of equity when the evidence is undisputed that applying Staff's methodology to updated data supports a 10.65% cost of equity.

Because Staff's and IIEC's estimates produce results so close to ComEd's when updated inputs are applied, ComEd argued in its Initial Brief that approval of ComEd's recommended 10.75% cost of equity is consistent with all of the evidence and presents an appropriate basis for

the Commission's return on equity determination. Just as Staff does not dispute that an update of its analysis produces a 10.65% cost of equity, IIEC does not disagree that its own CAPM study produced a 10.7% cost of equity, while its traditional DCF analysis outcome is even higher at 11%. IIEC Init. Br. at 34.

The principal objection raised by Staff and IIEC to Dr. Hadaway's 10.75% cost of equity result is their contention that Dr. Hadaway used a GDP growth rate in his DCF analysis that they believe is unsustainably high. Staff Init. Br. at 55; IIEC Init. Br. at 36. Importantly, this dispute turns out to be largely academic if the Commission accepts the need to use the most current data available. However, Staff's and IIEC's criticism is not well founded. While Dr. Hadaway did present a DCF analysis using the GDP growth rate, he recognized that the Commission favored use of analysts' estimates and therefore also performed stand-alone, DCF analyses using only analysts' growth rates. The analysts' growth rates of the companies in Dr. Hadaway's comparable group were actually 20% lower than the growth rates for Staff's sample group (6.05% versus 7.72%), further indicating the conservatism of Dr. Hadaway's approach. Staff Ex. 4.0 Schedule 4.5; ComEd Ex. 10.5. The updated quarterly dividend DCF analysis performed by Dr. Hadaway resulted in a reasonable cost of equity range of between 10.3 and 11.1 percent. ComEd Ex. 29.7. The midpoint of this reasonable range is 10.7%. Dr. Hadaway's presentation of alternative DCF analyses that do not rely on GDP growth rate estimates responds completely to the principal objection raised by Staff and IIEC. Dr. Hadaway's 10.75% cost of equity result is reasonable, is consistent with Staff's analysis in Ameren, with several of the studies performed by IIEC and with the update of the Staff analysis in this proceeding.

The arguments of Staff and IIEC in support of multi-stage rather than "constant growth" DCF analyses provide also no basis for approval of a low, 10.3% or 10.2% cost of equity for

ComEd. The issue is not whether a multi-stage model is used. The issue is whether updated information is applied when performing the analysis. Staff's multi-stage model is identical to the multi-stage model Staff used in the Ameren proceeding. When updated inputs are substituted for the outdated inputs on which Staff's 10.3% recommendation is based, Staff's multi-stage analysis results in a 10.65% cost of equity. ComEd Ex. 42.2, p.1.

Staff also criticizes Dr. Hadaway's risk premium analysis, contending that it contains "several flaws." Staff Init. Br. at 56. These disagreements, too, shrink in importance if updated data is used. However, Dr. Hadaway also explained why they were not well founded. While Dr. Hadaway's risk premium analysis is sound, risk premium results were only offered "for general perspective" and did not impact his 10.75% cost of equity recommendation. Hadaway Rebuttal, ComEd Ex. 29.0, 12:242-244; 21:430-432. In addition, Staff's own risk premium analysis concluded that ComEd's cost of equity is 11.25%. McNally Dir., Staff Ex. 4.0 Corr., 27:527-531; Staff Ex. 4.0, Schedule 4.9. Dr. Hadaway's electric utility risk premium result criticized by Staff actually came out lower than Staff's. Staff's attack on the 10.95% cost of equity indicated by Dr. Hadaway's risk premium analysis falls flat when Staff's own risk premium approach produced a higher 11.25% outcome. Moreover, after updating for more recent information, Staff's risk premium approach produces an 11.49% cost of equity. ComEd Ex. 42.2, p. 2. Therefore, even if Staff were correct that there are flaws in Dr. Hadaway's risk premium analysis, it would have no impact on the appropriate cost of equity for ComEd.

The only other cost of equity estimate was presented by CUB. Despite overwhelming evidence to the contrary, CUB argues that "[t]he ROE that investors require for their investment in ComEd is 7.77%," asserting that "[i]nvestors are content to demand a lower return to invest in ComEd than the Commission has granted any other electric utility in the past 30 years." CUB

Init. Br. at 18, 29. For all of the reasons identified by Staff and for the additional reasons explained by Dr. Hadaway, it is clear that CUB's view is unfounded and its results are far fetched, to say the least. The weakness of ComEd's financial condition is unprecedented and is among the poorest of any major utility; yet CUB asks the Commission to believe investors are content to inject their capital at rates of return lower than awarded to any other utility in a lifetime. Thomas, Tr. 1837:17 - 1840:15. CUB gets to this result only by using methodologies and assumptions that the Commission has considered and repeatedly rejected when determining utilities' cost of equity. Thomas, Tr. 1844:2 - 1854:3. CUB's annual version of the constant growth DCF model was rejected in the *Peoples Gas* Order (at 99). Hadaway Reb., ComEd Ex. 29.0, 21:436-438. CUB's growth rate for its DCF analysis is based entirely on the "b times r" sustainable growth rate approach, which the Commission rejected in *GTE North*, Docket Nos. 93-0301, 94-0041 (Order, October 11, 1994). Hadaway Reb., ComEd Ex. 29.0, 21:438-441. CUB's recommendation to discontinue use of the CAPM approach is also rejected by the Commission, most recently in the *Peoples Gas* Order (at 97). No basis in the record supports approval of CUB's thoroughly discredited 7.77% cost of equity.

The appropriate course of action based on the record is to approve a 10.75% cost of equity for ComEd. If the Commission determines not to approve a 10.75% cost of equity because of a preference for Staff's methodology, it should approve the 10.65% cost of equity resulting from Staff's analysis using updated inputs.

D. Overall Cost of Capital (Derivative)

If the Commission approves a 10.75% cost of equity, ComEd's overall cost of capital will be 8.57%. Init. Br. at 65. If the Commission approved Staff's updated 10.65% cost of equity,

ComEd’s overall cost of capital will be 8.53%. These alternative results are summarized on the following chart:

Class of Capital	Proportion	Cost	Weighted Cost at 10.75% ROE	Weighted Cost at 10.65% ROE
Long-Term Debt	54.96%	6.78%	3.73%	3.73%
Common Equity	45.04%	10.75% or 10.65%	4.84%	4.80%
Total Capital	100%		8.57%	8.53%

E. Effects of Riders SMP and SEA

In its Initial Brief, ComEd described the evidence supporting rejection of proposed downward adjustments to ComEd’s return on equity in the event that Riders SMP or SEA are approved. Dr. Hadaway explained that no such downward adjustment is warranted and that the 10.75% return on equity he recommends is appropriate whether or not the Commission approves Rider SMP. Hadaway Reb., ComEd Ex. 29.0, 23:487-24:502. No analysis in the record supports the proposed negative adjustment in ComEd’s rate of return. Id. at 23:490-93. Staff’s Brief also reiterates its position that “there should be no adjustment to the cost of equity for rate base assets” if Rider SMP is approved. Staff Init. Br. at 66.

While not arguing for a reduction in ComEd’s return on equity, Staff and CUB do contend that the terms of Rider SMP should provide for a lower return on the particular rate base assets covered by the Rider. Staff candidly acknowledges that it “has not presented a specific cost of equity proposal for Rider SMP because Staff is not aware of an appropriate means to quantify” such a proposal. Staff Init. Br. at 67. While CUB makes a specific proposal – that the return on these projects should be limited to ComEd’s 6.74% cost of long-term debt (CUB Init. Br. at 31) – CUB’s proposal is both unsupported and facially unreasonable. Even if Rider SMP

is presumed to lower the equity investment risk with respect to these assets, it does not lower that risk to the level of debt. Thomas, Tr. 1856:14 - 1860:17. Moreover, CUB's proposal is unsupported by any study showing that 6.74% is an appropriate rate of return for Rider SMP projects or establishing that ComEd's cost to finance such projects will be lower than its overall cost of capital. The evidence is to the contrary. ComEd's equity costs will not be lowered. McDonald Reb., ComEd Ex. 28.0, 24:511-25:546; McDonald Sur., ComEd Ex. 41.0, 12:246-57; Hadaway Reb., ComEd Ex. 29.0, 23:487-24:509.

Finally, IIEC continues to propose a .5% reduction in ComEd's entire cost of equity if Riders SMP and SEA are approved. IIEC Init. Br. at 43. IIEC refers to no analysis supporting this extreme view, because none exists. Similarly, AARP and the Commercial Group argue for the first time in their briefs that an unspecified downward adjustment to ComEd's return on equity should be made, but also have no analysis backing up their claim. Neither presented any evidence in support of such an adjustment.

The record does not support adoption of a downward adjustment to ComEd's return on equity in the event that Riders SMP or SEA are approved. Staff and ComEd agree nothing supports reducing ComEd's return on equity or overall rate of return on rate base assets if Riders SMP or SEA are approved. Dr. Hadaway's testimony specifically considers the issue and concludes that the 10.75% cost of equity supported by his analysis is appropriate whether or not the Commission approves Rider SMP. No contrary analysis supports any proposed downward adjustment. When no evidence supports a proposed adjustment, the Commission should reject it. The Commission should, therefore, enter an order that is consistent with the evidence and decline to adopt the proposed downward adjustment to ComEd's return should Rider SMP and/or Rider SEA be approved.

VII. NEW RIDERS

A. Overview

ComEd proposed two new riders – Riders SMP and SEA – that remain contested. The Commission should approve both.

- Approving Rider SMP in this case is the only way customers can begin receiving the significant and widely acknowledged benefits of Smart Grid technologies without lengthy and needless delay. Deferring consideration of Smart Grid to potentially lengthy and vaguely defined processes would needlessly stall the evolution of the Smart Grid in Illinois.
- ComEd has significantly modified the Rider SMP process, so that robust stakeholder input precedes any program proposal. ComEd and the parties have expended considerable resources in arriving at a reasonable middle ground. These efforts should be preserved, particularly because the Commission remains in complete control of any projects that are approved, and there is no risk of Rider SMP being misused for inappropriate or inadequately reviewed technologies or projects.
- Rider SEA ensures that customers neither under- or over-pay for the costs of storm restoration work.

Some parties, particularly the AG, claim that these riders are outside the Commission’s authority and may not be approved, or are contrary to ratemaking principles and should not be approved, no matter how beneficial they are. They are wrong. Riders such as these are well within the parameters of the Commission’s lawful authority, as has been recognized for forty years under varying circumstances. *E.g., City of Chicago v. Illinois Commerce Comm’n*, 13 Ill. 2d 607, 611 (1958) (“*City I*”) (recognizing that “it is clear that the statutory authority to approve

rate schedules embraces more than the authority to approve rates fixed in terms of dollars and cents”); *A. Finkl v. Illinois Commerce Comm’n*, 250 Ill. App. 3d 317 (1st Dist. 1993) (“*Finkl*”) (reversing order allowing rider recovery of a type of ordinary costs that should have been included in rate base); *City of Chicago v. Illinois Commerce Comm’n*, 264 Ill. App. 3d 403 (1st Dist. 1993) (“*City II*”) (affirming order approving rider recovery of marginal cost of providing non-standard service); *Central Illinois Light Co. v. Illinois Commerce Comm’n*, 255 Ill. App. 3d 876 (3rd Dist. 1993) (“*CILCO*”) (finding no abuse of discretion in the Commission’s approval of coal tar remediation cost recovery through a rider mechanism); *Citizens Utility Board v. Illinois Commerce Comm’n*, 166 Ill. 2d 111, 140 (1995) (“*CUB*”) (determining that the “Commission’s approval of a rider as the preferred mechanism for recovery of coal-tar cleanup costs is within the Commission’s authority”); *City of Chicago v. Illinois Commerce Comm’n*, 281 Ill. App. 3d 617 (1st Dist. 1996) (“*City III*”) (affirming Order approving the use of a rider to recover local franchise fees).

The Commission very recently analyzed this precedent in detail and reconfirmed its authority to approve rider mechanisms in cases such as this. In *Peoples Gas*, the Commission was presented with several new “tracker” riders for approval, which were opposed by several parties on essentially the same grounds argued here. *Peoples Gas* at 126, 89.. The Commission conducted a thorough review of its authority “from the very beginning... in the matter of riders.” *Id.* at 139. It found that the pertinent case law unquestionably demonstrates that the Commission has authority to approve rider mechanisms under the proper circumstances:

[W]e observe, 37 years after it set out the seminal pronouncements in this field, the Illinois Supreme Court highlighted *City I* to affirm the Commission’s discretion in selecting the means by which rates are set and costs are recovered, and the appropriateness of the rider mechanism in certain instances. *CUB v. ICC*, 166 Ill. 2d 111 (1995). Thus, the whole of the case law settles the question of our

authority to adopt the rider mechanism in proper situations and under circumstances that are lawful and reasonable.

Id. at 139-40.

Moreover, the Commission in *Peoples Gas* concluded, after analyzing the precedent, that a rider mechanism does not violate the regulatory doctrines of single-issue ratemaking, retroactive ratemaking and the Commission's test year rules. It found:

- Single-Issue Ratemaking: "From the whole of this authority, we believe it clearly established that the prohibition against single issue ratemaking is operable only in the context of a rate case, and during the phase that balances the utility's cost and allowed revenues under the $R=C+Ir$ formula. It is not applicable to a rider that merely facilitates direct recovery of a particular cost without upsetting a utility's revenue requirement."
- Retroactive Ratemaking: "The sound and enduring analysis in *City I* makes clear that an automatic rate adjustment clause does nothing to change the fixed and prospective nature of rates approved by the Commission. ... This simply means that where a rate schedule approved by the Commission contains a mathematical formula for making future changes in the rate schedule, it is not unlawful under the doctrine of retroactive ratemaking."
- Test Year Rules: "We observe that the Illinois Supreme Court ultimately settled the question in *CUB v. ICC*, when it directly addressed the argument that a rider violates the Commission's own test year rules. ... In the end, the Court resolved that the test year rule seeks to avoid a problem that is simply 'not present' when expenses are recovered through a rider. "

Peoples Gas at 142, 145-46 (citations omitted).

The Commission’s exhaustive analysis and clear affirmation of its authority to approve riders in *Peoples Gas* sends a clear message to those who would continue to offer the same arguments here. *See, e.g.*, AG Init. Br. at 23, 29-35; CUB Init. Br. at 33-36; NUCOR Init. Br. at 6-7; IIEC Init. Br. at 50-52. ComEd will not repeat that analysis in countering those arguments. Instead, ComEd respectfully refers generally to the Commission’s reasoned and thorough discussion of its rider authority.

The AG’s additional argument that Rider SMP and Rider SEA do not satisfy the mandate of the Act that rates be least-cost is unsupported and even illogical. The Commission must approve Rider SMP projects in advance and will only approve projects that are beneficial. “Least cost” is an efficiency standard – customers should receive their services at the least cost – not a prohibition on investing to improve service or a bar to providing more beneficial services. Moreover, both proposed riders include a reasonableness review of actual costs during annual reconciliation proceedings, so the Commission will have the opportunity to determine whether the costs sought to be recovered under the riders are reasonably incurred. *See* 220 ILCS 5/1-102(a)(iv). These same arguments were raised in *Peoples* and rejected by the Commission. *See Peoples Gas Order* at 175, 183-184.

The AG and CUB further argue that there are narrow criteria that must be met before the Commission should approve a rider “as an extraordinary cost recovery mechanism.” AG Init. Br. at 26-29. The AG says that the expenses sought to be recovered under a rider must be large, volatile and beyond the control of management, citing *Finkl*. CUB also cites *Finkl* and argues that rider recovery is permitted only where “the costs in question are ‘unexpected, volatile or fluctuating,’ and beyond the control of the utility.” CUB Init. Br. at 35.

The AG's and CUB's construction of *Finkl* as setting forth an exclusive list of criteria for approval of riders³⁰ is flatly wrong. Indeed, the same Illinois court that decided *Finkl* later confirmed that use of a rider is not limited "only to those cases where expenses are unexpected, volatile, or fluctuating" (*City III*, 281 Ill. App. 3d 617 at 628) and specifically rejected arguments that its earlier decision in *Finkl* so limited the use of riders. *Id.* Moreover, the Commission confirmed in *Peoples Gas* that the *Finkl* standards are not exclusive "all-or-nothing factors." *Peoples Gas* at 186. The AG's and CUB's construction of *Finkl* is puzzling in light of the Illinois Appellate Court's clear pronouncement in *City III* and the Commission's analysis of the decision in *Peoples Gas*:

Notably, in [City III], the court considered the City's reliance on Finkl for the very proposition that only unexpected, volatile or fluctuating expenses are properly recovered through a rider. This opinion (and, notably, by the very same appellate district that decided Finkl) makes clear that:

A *Finkl*, however, should not be so narrowly construed. In A. *Finkl*, we stated that "riders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses." (Emphasis omitted.) A. *Finkl*, 250 Ill. App. 3d at 327, 620 N.E.2d at 1148. Nothing in the language of A. *Finkl*, or the case upon which we relied, Citizens Utility Board, 13 Ill. 2d at 614, 150 N.E.2d at 780, limits the use of a rider only to those cases where expenses are unexpected, volatile, or fluctuating. *Id.* at 628.

Thus, the City III court construed the opinion of the Illinois Supreme Court to mean that there is no requirement and no limitation on the Commission to use a rider mechanism only for costs that are unexpected, volatile or fluctuating. This brings us back to the pronouncements that riders are allowable in the proper case, and under circumstances that reflect the need for pragmatic adjustments.

Peoples Gas at 149-50 (emphasis added).

³⁰ CUB and AG variously assert applicable criteria as being large, volatile, fluctuating, unexpected or beyond the control of the utility. AG Init. Br. at 26-29; CUB Init. Br. at 35-36. Some of these are not mentioned in *Finkl*.

The certainty of the Commission's rider authority and the wide discretion the Commission enjoys is underscored in *Peoples Gas*, where the Commission approved two new riders involving categories of recovery not theretofore the subject of riders. Those categories, margin revenues and energy efficiency program costs, arose from the implementation of novel programs and demonstrate the Commission's latitude in identifying "circumstances that reflect the need for pragmatic adjustments." *Peoples Gas Order* at 150; *see also City I*, 13 Ill. 2d at 618; *Peoples Gas Order* at 150-53, 183-84. To underscore that point, the Commission in *Peoples Gas* noted that it would view an infrastructure rider favorably if certain conditions were met and went on to indicate its willingness to consider appropriate system modernization proposals. *Peoples Gas Order* at 161-62. Rider SMP and Rider SEA recover unique types of costs in a manner that justifies the Commission's approving pragmatic rate adjustments in the form of riders.

In sum, both Rider SMP and Rider SEA satisfy the legal standards for rider recovery most recently recognized by the Commission's order in *Peoples Gas*. Moreover, as discussed in further detail below, both rider proposals are appropriate and necessary cost recovery mechanisms. Accordingly, Rider SMP and Rider SEA should be approved by the Commission.

B. Rider SMP

Deployment of Smart Grid technologies is a significant undertaking that will require hundreds of millions of dollars of investment but also promises great benefits to customers and is essential to the continued growth and prominence of the northern Illinois region. Most parties acknowledge the tremendous benefits, including improved reliability and reduced energy use, that can be achieved by deploying a Smart Grid.³¹ Several parties affirmatively urge the

³¹AG Init. Br. at 44; CNE Init. Br. at 2; BOMA Init. Br. at 4-5; RESA Init. Br. at 3-5; CUB Init. Br. at 40; Kroger Init. Br. at 2; Schlaf Reb., Staff Ex. 20.0, 10:196-98; Schlaf Supp. Dir., Staff Ex. 9.0, 12:260-13, 15:314 - 17:361.

Commission to approve a mechanism like Rider SMP to help achieve those benefits in a timely manner.³² Rider SMP offers the Commission a unique opportunity to make the region a leader in Smart Grid deployment through a process that actively involves other stakeholders and greatly minimizes financial, technical, and regulatory risks. Rider SMP is also fully consistent with the Commission's obligations under the federal EISA.

The positions taken by the parties present the Commission with a stark choice: either to approve a focused, well-defined, and balanced process; or to embark on an ill-defined, uncertain, and likely duplicative series of proceedings. The former choice is a measured alternative that features (1) a robust initial workshop process in which Staff and all stakeholders play a major role, (2) direct Commission control over project selection and approval, (3) after-the-fact review of ComEd's investments, and (4) safeguards modeled after the Commission's successful water utility investment riders. Moreover, approval of Rider SMP in this case will provide regulatory certainty around the essential framework for evaluating proposed Smart Grid projects, without which the process cannot proceed.

By contrast, the latter choice is a process with duplicative workshops and/or other proceedings, continued regulatory uncertainty, and no clear framework for action. Such an approach would be very unlikely to deliver real Smart Grid benefits to customers in the foreseeable future, if ever. Such an approach would also bolster the hand of those few parties who oppose Rider SMP entirely. Their hostility to regulatory certainty and full cost recovery for this capital intensive technology will delay the Smart Grid indefinitely or defeat it entirely. That would be detrimental for customers and for Illinois generally.

³² CNE Init. Br. at 2-5; BOMA Init. Br. at 4-6; RESA Init. Br. at 2-5.

1. Approving Rider SMP Minimizes Risk to the Commission and Customers

Rider SMP is designed to reduce the risks to customers of deploying new Smart Grid technology. It provides for a focused stakeholder workshop proceeding to consider prospective technologies. That workshop process is designed to explore and vet competing options and to actively solicit and incorporate views of others. *See* Fein Reb., CNE Ex. 2.0, 3:46 – 4:53; Mitchell Dir., ComEd Ex. 1.0, 11:243-12:257; Crumrine Dir., ComEd Ex. 11.0, 17:341-18:354. Potential projects will be separately evaluated and discussed by stakeholders in workshops covering a 6-month period.³³ Only after this workshop process will any projects be submitted to the Commission for pre-approval.

Moreover, unlike costs of other technology investments, the costs of Smart Grid investments will only be passed through to customers if they are for projects that have been specifically approved by the Commission after a formal proceeding in which parties can again participate. Fein Reb., CNE Ex. 2.0, 4:65-72; Crumrine Dir., ComEd Ex. 11.0 Corr., 16:316-19, 17:321-22, 19:370-77; Crumrine Reb., ComEd Ex. 30.0, 4:76-81, 19:427-30; Crumrine Sur., ComEd Ex. 43.0, 6:111-15. Compared to the process used to select technology under the “traditional” regulatory model, where technologies are unilaterally chosen by utilities, subject only to after-the-fact regulatory examination limited by the proscription on improper hindsight review of management prudence, Rider SMP provides additional layers of regulatory review.

Although Rider SMP is a framework for considering, reviewing, and adopting Smart Grid technologies, it is imperative that the rider framework be in place. The regulatory and rate recovery certainty it establishes is what will enable ComEd to fund system modernization and

³³ ComEd has even agreed that these workshops can be conducted by a third party facilitator.

consider investments in these technologies. While Rider SMP poses no unfair risk to customers, investing in a Smart Grid if Rider SMP is rejected would pose unfair and untenable risks for ComEd. McDonald Sur., ComEd Ex. 41.0, 12:262 – 13:264. Indeed, without regulatory certainty the rider provides, and given ComEd’s current financial condition, it would be inappropriate for ComEd to take on the additional capital requirements of Smart Grid program. ComEd cannot make the required investments “on spec.” Rider SMP is the only means by which ComEd can be assured that the decision to invest hundreds of millions of dollars in particular Smart Grid technologies will not be second guessed or put at risk after the Commission has approved those investments.

For this same reason, the basic terms of Rider SMP cannot be left open or made subject to reevaluation or revision in additional workshops or some undefined statewide rulemaking, as proposed by Staff and certain Intervenors. Staff Init. Br. at 69, 73-74, 80-81; CUB Init. Br. at 46. The Rider mechanism not only provides regulatory certainty to ComEd, but will also signal to the financial and capital markets that ComEd will recover its costs of approved Smart Grid investments. Approval of the Rider does not preclude rigorous Commission and stakeholder evaluation of Smart Grid projects and technology, but any failure to establish with certainty a mechanism for review of that technology and recovering resulting costs would effectively hamstring further consideration of Smart Grid technology on the ComEd system.

2. There is No Risk that ComEd Will Pass Through Inappropriate Costs Under Rider SMP

Several parties have argued that ComEd’s Rider SMP definition is overbroad or otherwise problematic. Staff Init. Br. at 75; REACT Init. Br. at 13; CUB Init. Br. at 37; AG Init. Br. at 55-56. CUB has even made the specious claim that Rider SMP would permit ComEd to recover the cost of an investment in pole climbing footwear. CUB IB at 37. Such criticisms are

exaggerated and misplaced. As discussed above, proposed projects must first proceed through a robust workshop process. After that, they must be proposed by ComEd to the Commission. If the Commission decides for any reason that a particular project is inappropriate, it will not approve that project, and no resulting costs will be passed on to customers under Rider SMP. Concerns about the scope of the rider's definition of system modernization projects are misplaced because ComEd can only recover costs under Rider SMP of projects that the Commission explicitly approves. Arguments that the costs of inappropriate projects might be recovered under Rider SMP either ignore this fact or belie a mistrust in the Commission's judgment and oversight ability.³⁴

Nonetheless, in an effort to further narrow the issues, ComEd will accept the definition of the scope of potential projects proposed by Staff, *i.e.*, the list of nine items on page 78 of Staff's Initial Brief. This Smart Grid definition consists of descriptions of specific functions that are derived from Section 1301 of EISA. Staff Init. Br. at 77-78. Based on what ComEd presently knows of Smart Grid technologies, this list is acceptable for the time being and unlikely to bar technologies that are poised to offer significant currently known benefits to customers.

Finally, Rider SMP should not be further modified based on expressed concerns about when recoveries under Rider SMP will terminate. *See* Staff Init. Br at 80. The Commission will periodically review all projects and when new projects are no longer approved is ultimately a matter that will be determined by the Commission. There is no need to establish limits on the Commission's ability to approve technologies or programs requiring longer-term investments if it determines that continued investment and cost recovery are in the public interest.

³⁴ Similarly, concerns about when recoveries under Rider SMP should terminate, *See* Staff IB at 80, are also matters to be determined by the Commission. There is no need to establish such time frames in the tariff.

3. The Record Establishes That SMPs Will Offer Substantial Benefits To Customers

ComEd's witnesses, Ms. Clair, Dr. George, and Mr. Donnelly presented affirmative and compelling testimony that considerable benefits to customers and the system will result from the deployment of AMI and other Smart Grid technologies.³⁵ Staff and CUB also identify considerable benefits that the Smart Grid can provide, as noted above.

Only AARP argues that no benefits will arise from Smart Grid. AARP offers little explanation for this assertion and no evidence to counter the ComEd, Staff, and Intervenor testimony concerning the benefits. The record quite clearly establishes that Rider SMP confers substantial benefits to customers and the system as a whole.³⁶ Moreover, the largely unsupported arguments of no benefit should not be allowed to block so important an initiative as Smart Grid deployment. It is simply undisputed that only Rider SMP will enable ComEd to deliver Smart Grid benefits in a timely and deliberative manner.

4. ComEd's Workshop and Pre-Approval Framework and Timelines Are Reasonable

No one can plausibly dispute the significant benefits that Smart Grid technologies can provide to customers and the state. Perhaps for this reason, the disagreement with Rider SMP focuses on the process for selection of particular technologies and with the mechanics of the Rider SMP tariff. Staff and other parties have made several proposals concerning the process for

³⁵ Clair Dir., ComEd Ex. 6.0, 13:287 – 14:295; Clair Reb., ComEd Ex. 23.0 Corr., 6:126-31, 14:288 – 25:532, 33:713-31; George Reb., ComEd Ex. 31.0, 4:78 – 6:128, 23:467-75, Donnelly Reb., ComEd Ex. 21.0 Corr., 89:1792-1800, 93:1881 – 94:1893, 99:2015 – 101:2058, 102:2070 – 104:2136.

³⁶ While the AG suggests that competitive services and RESs may improperly benefit from AMI, the AG's suggestion is superficial and ill conceived. Any benefit to competitive services would be incidental and outweighed by the overall benefits to customers and the system. Additionally, any arguable RES benefit is really one that inures to customers by increasing their flexibility in the use of delivery services. Also, while the railroads question the degree of their own benefit, they acknowledge that Smart Grid technologies are beneficial. Bachman Sup. Dir., METRA/CTA Joint Ex. 2.0, 1:15 – 2:3.

identification of potential projects and the specifics of Rider SMP itself. Staff Init. Br. at 76-81; CUB Init. Br. at 40-45; REACT Init. Br. at 17-18.

ComEd's SMP framework, however, including the workshop format proposed by CNE, is the most reasonable and balanced approach to identifying and implementing beneficial Smart Grid technologies. This process is a synthesis of the most reasonable proposals for evaluating and implementing Smart Grid technologies, but also recognizes the reality that ComEd cannot undertake investments in these technologies without the assurance of timely recovery of its prudent and reasonable capital costs. The six-month workshop period provides a generous, yet focused and finite, period of time for ComEd and the stakeholders to identify, discuss, and evaluate specific technologies and projects. This permits the timely consideration by the Commission of the basic building blocks of AMI and Smart Grid specifically tailored to the ComEd system. The advance approval of the prudence of undertaking a project provides the required certainty, while the after-the-fact review protects customers from imprudent or unreasonable implementation of those projects. The strong Commission involvement will permit it to exercise the type of focused leadership required to get such a major process underway with due consideration of the interests of all stakeholders.

By contrast, a statewide collaborative or other proceeding without a specified timeline or lacking a defined focus on technology review will be unable to complete this task, especially if it also is reconsidering the structure of the rider mechanism itself. *See e.g.*, CUB Init. Br. at 40-45; Staff IB at 76-81. A generic or one-size-fits-all approach would not recognize the critical difference between ComEd's and other utility systems³⁷, or the substantial work that has already

³⁷ For example, ComEd has different meters currently installed. It uses different data processing systems, has a different SCADA system, etc. Moreover, ComEd is a purely Illinois utility and its choice of technology need not be affected by the demands of other states.

been done by ComEd in furtherance of Smart Grid on its system. The Smart Grid choices that are best for ComEd are not likely to be best for Ameren, let alone for MidAmerican or Mt. Carmel.

Likewise, proposals for collaborative processes that go beyond addressing technologies, that involve an open ended time frame, amorphous agendas or ill-defined objectives, or that delve into broad theoretical precepts such as the definition of basic service or minimum service (*see, e.g.*, Staff IB at 80-81; AG IB at 61-62), should be rejected. They are not only unnecessary, but will defeat any regulatory certainty associated with the process. Crumrine Reb., ComEd Ex. 30.0, 19:435 – 20:449. They will have the effect of needlessly delaying, perhaps indefinitely, the deployment of Smart Grid technology in Illinois. The Commission must recognize that the practical impact of not approving a specific structure now is that it may be some years before a framework for making approved investments will again be presented. Crumrine Reb., ComEd Ex. 30.0, 22:509 – 23:519. The record in this case on the question of the SMP process is substantial and complete, and a detailed compromise proposal is now before the Commission. Scrapping that record and embarking on new studies, analyses, and workshops will most assuredly thrust consideration of the mechanism for implementing a Smart Grid into a confused and uncertain state. “Paralysis by analysis” is not the best strategy for Illinois.

Finally, the Commission should reject Staff’s proposal that Rider SMP become a pilot program with a specified sunset date. Any concern regarding the ongoing operation and implementation of Rider SMP can be adequately addressed without the imposition of such a rigid approach as Staff proposes. The Commission may simply provide for a review of the effectiveness of the operation of Rider SMP, say in 2013 when two approval cycles will have been completed. This will provide parties with some assurance that the rider will be reviewed in

the future and that the Commission will not be approving a "forever" rider. It should be noted, however, that the Rider SMP is "self-policing" in the sense that the Commission always has full control over which projects are approved and which costs are flowed through the rider. If, in the future, the Commission has concerns about the scope or effectiveness of Rider SMP, it can exercise any necessary control by simply refusing to authorize any additional projects for rider recovery. Thus, Staff's sunset proposal is not necessary for effective Rider SMP oversight.

5. ComEd Has Reasonably Addressed Staff's Proposals Regarding the SMP Tariff

Staff witness Hathhorn proposed specific revisions to language in Rider SMP, many of which have been revised during the proceeding. ComEd has subsequently accepted these specific tariff revisions. Staff Init. Br. at 78-79.

Staff also proposes that Rider SMP should be refiled following the end of the collaborative workshop process Staff proposes. As discussed above, ComEd is opposed to reconsidering Rider SMP itself in workshops that should be focused on technology. Furthermore, Rider SMP need not be refiled. Rider SMP, as revised, fully and reasonably addresses all procedural and rate matters pertaining to system modernization on the ComEd system.

6. Amortization Period for Regulatory Asset

ComEd discussed the evidence supporting its proposal in its Initial Brief (at 82-83). Staff's Initial Brief (at 78-80) references the subject, but does not require further discussion.

C. Rider SEA

In addition to the legal arguments raised in opposition to riders in general, addressed in Section VII.A, *supra*, several parties have objected to the specifics of Rider SEA and questioned whether it comports with the legal criteria for riders. As shown in ComEd's Initial Brief, Rider

SEA tracks O&M expenses related to storm restoration work and provide a dollar-for-dollar recovery of such expenses through a combination of base rates and the rider itself. ComEd Init. Br. at 83-90; Crumrine Dir., ComEd Ex. 11.0 Corr., 13:234-36. Rider SEA is in everyone's best interest because customers would pay no more than the actual storm restoration O&M expenses, and annual variations in these expenses will not detract from ComEd efforts to provide safe and reliable service. Crumrine Dir., ComEd Ex. 11.0 Corr., 16:310-13. Rider SEA should be approved because it is a fair and reasonable means of recovering ComEd's storm restoration expenses.

1. Rider SEA is a Proper Cost Recovery Mechanism

Several parties claim that Rider SEA is legally insufficient because storm expenses are not unexpected, volatile or materially fluctuating. AG Init. Br. at 70-72; CUB Init. Br. at 46; Staff Init. Br. at 82-87. First, as discussed above, there is no inflexible requirement that a cost recovery rider satisfy specific criteria before the Commission may approve it.

Moreover, Rider SEA falls squarely within circumstances in which the Commission has previously approved rider recovery. *CUB*, 166 Ill. 2d 111 at 138 (1995) (“[A] rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile or fluctuating expenses.”). Specifically, Rider SEA is a proper mechanism for cost recovery because ComEd's storm repair O&M expenses are material (*i.e.*, they involve very large costs), highly volatile from year to year, and unpredictable and uncontrollable. G. Williams Dir., ComEd Ex. 4.0 2nd Corr., 66:1329-32. In addition, storm repairs are a substantial part of ComEd's distribution corrective maintenance work, representing approximately 18.8% of all such expenses, which, in turn, affects expenditures on other projects and programs. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 9:175-10:184. Finally, Staff's review of historic storm

expenses confirms that such amounts are inherently unpredictable, reflecting annual differences of -71% and 102%, respectively, and a range of \$47 million. ComEd Init. Br. at 88; Luth Dir., Staff Ex. 6.0, 15:260-68. Indeed, this fluctuation in costs, particularly where costs exceed those allowed in current rates, represents a significant portion of ComEd's expected earnings and therefore has a big impact on the financial community and its operations.

ComEd's showing, summarized above, regarding the materiality, volatility and unpredictability of its storm repair expenses also rebuts the argument by several parties that ComEd has failed to demonstrate the need for recovery separate from standard cost recovery. AG Init. Br. at 72-74; CG Init. Br. at 5; IIEC Init. Br. at 50-51; METRA Init. Br. at 12-13.

2. Rider SEA Adequately Protects Customers And Provides for Commission Monitoring

The AG claims that Rider SEA "does not allow any meaningful examination of the prudence or reasonableness of storm expenses that ComEd collects from ratepayers." AG Init. Br. at 75. Other parties claim that Rider SEA either shifts significant risk from ComEd to its ratepayers or does not sufficiently protect ratepayers. *See* NUCOR Init. Br. at 6-7; IIEC Init. Br. at 51; CG Init. Br. at 5. These claims are unfounded.

ComEd's revised proposal for Rider SEA provides for annual reconciliation proceedings during which the costs recovered through Rider SEA will be subject to review. Crumrine Reb., ComEd Ex. 30.0, 39:870-73; ComEd Ex. 30.2. Thus, the Commission will annually review the reasonableness of ComEd's storm expenses, as well as the classification of costs as storm expenses, ensuring that ComEd recovers no more and no less from its customers than the actual costs reasonably incurred for storm expenses. These reconciliation proceedings are substantially similar to the reconciliation proceedings the Commission regularly conducts, as well as being

substantially similar to the process approved by the Commission in ComEd's last rate case in connection with Rider ECR. Docket No. 05-0597, Order at 212-13.

The annual reviews also address the concerns of certain parties that Rider SEA will encourage ComEd to improperly classify costs as storm expenses or might remove incentives for ComEd to appropriately control the costs of storm restoration activities. Staff Init. Br. at 89-90; AG Init. Br. at 68-70; NUCOR Init. Br. at 6-7. The Commission's annual review of the reasonableness of ComEd's storm expenses is more than sufficient incentive for ComEd to properly classify or define a cost as eligible for recovery under the rider and to manage its storm restoration efforts efficiently. Crumrine Reb., ComEd Ex. 30.0, 33:755 – 34:759, 35:781-83.

Rider SEA actually improves the determination of how much ComEd's customers are charged for storm repairs. Crumrine Reb., ComEd Ex. 30.0, 30:681-89. And, under Rider SEA, customers may receive a credit instead of being charged for storm expenses. *See, e.g.*, ComEd Ex. 30.2. Therefore, Rider SEA adequately protects ComEd's customers.

3. Rider SEA Will Not Lead To Reduced System Maintenance

Staff and IIEC maintain that Rider SEA will eliminate disincentives to ComEd for failing to properly maintain its electric delivery system. Staff Init. Br. at 87-89; IIEC Init. Br. at 50-52. However, their arguments fail to consider that ComEd will continue to be subject to potentially significant statutory economic consequences for failure to properly maintain the electric delivery system whether or not Rider SEA is approved. *See* 220 ILCS 5/16-125(e), (f). Moreover, ComEd's preventative maintenance addresses problems anticipated to arise under normal operations, including normal weather events, and simply does not address the types of problems that storms create for ComEd, which will be addressed by Rider SEA. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 8:157-9:172.

4. Proposed Revisions to Tariff Language

Staff continues to recommend numerous changes to Rider SEA in the event the Commission determines the rider is appropriate. Staff Init. Br. at 92-95. Staff claims that these changes are intended to address: “1) subjectivity in the definition of Storm; 2) terminating certain customer charges if ComEd service deteriorates significantly; 3) establishing a prudence requirement; identification of recoverable costs; and internal audit requirement; and 4) setting a baseline O&M amount to remain constant between rate cases.” *Id.* ComEd will address each of the proposed changes in turn.

First, Staff’s proposal to change the definition of “storm” to the definition used by the National Weather Service should be rejected because that definition does not coincide with the events that drive ComEd’s response costs. G. Williams Reb., ComEd Ex. 22.0 2nd Corr., 10:187-89. Specifically, the existing definition triggers the rider exactly when needed: when, due to an act of nature, ComEd must open the storm center and 10,000 or more customers will be without power for three or more hours. *Id.* at 10:194-96. The National Weather Service concept does not consider the number of customers who will lose power or what may damage ComEd’s distribution facilities. *Id.* at 10:189-92.

Second, Staff’s proposal to modify Rider SEA to terminate charges to customers if ComEd’s service reliability deteriorates is inappropriate. *Id.* at 10:203 - 11:208. The events that Rider SEA is meant to address, *i.e.*, widespread outages from a major event not in ComEd’s control, will tend to increase the SAIFI and CADI reliability statistics referred to by Staff (System Average Interruption Frequency and Customer Average Interruption Duration Index). *Id.* Accordingly, under Staff’s proposal, a year with several bad storms would cause Rider SEA to be terminated. *Id.* This would not be good policy, because Rider SEA would be most needed and most beneficial if ComEd were hit with several bad storms in the same year. *Id.*

Finally, Staff states that ComEd accepted its proposed changes regarding a prudence requirement, the identification of recoverable costs, annual internal audits, and setting a baseline O&M amount. Staff Init. Br. at 95. While ComEd generally accepted these proposed changes, ComEd reiterates several exceptions to Staff’s proposals that were noted in ComEd’s rebuttal testimony and its Initial Brief: (1) ComEd proposed the addition of a new term, “O&M,” to further clarify the costs to be recovered (Crumrine Reb., ComEd Ex. 30.0, 39:877-89); (2) ComEd clarified that it did not object to making a change in the rider to the extent Staff is proposing the removal of regular wages from both the “Baseline O&M” and “Actual O&M” computations in the Rider SEA formula (*id.*, 39:892 - 40:901); and (3) ComEd objected to one of the tests proposed by Staff for inclusion in the internal audit provisions (*id.*, 40:909 – 41:920). ComEd Init. Br. at 86-87.

5. Rider SEA’s Recovery Mechanism

If the Commission approves Rider SEA, DOE accepts the recovery mechanism proposed by ComEd in surrebuttal testimony. DOE Init. Br. at 2. Specifically, ComEd proposed combining the recommendations of IIEC and DOE regarding cost allocation under the rider. Crumrine Sur., ComEd Ex. 43.0 Corr., 28:610 - 29:647. Under this combined approach, ComEd would determine fifteen separate charges or credits under Rider SEA, one for each distribution class. *Id.* at 29:625-26. Such charges or credits would be determined based on the percentage of storm restoration expenses allocated to each class according to ComEd’s ECOSS. *Id.* at 29:626-28. A single “automatic reconciliation amount” or “AR” factor should be employed to determine the charges or credits for all classes. *Id.* at 29:633-34. ComEd proposes to track the total difference between the costs or credits to be recovered or refunded from all fifteen classes and

the costs or credits actually recovered or refunded from all classes during the calendar year. *Id.* at 29:637-40.

D. Rider UF (Uncontested)

This issue remains uncontested. No other party's Initial Brief addressed this issue.

VIII. COST OF SERVICE AND ALLOCATION ISSUES

A. Overview

ComEd presented a valid embedded cost of service study ("ECOSS") that reasonably allocates distribution-related costs to the various retail customer classes. Heintz Dir., ComEd Ex. 13.0 Corr., 1:10-12, 5:106-07; ComEd Ex. 33.1. The ECOSS follows the same basic structure that was used and approved in ComEd's last three rate cases, ICC Docket Nos. 99-0117, 01-0423 and 05-0597. Heintz Dir., ComEd Ex. 13.0 Corr., 6:120-31; Heintz Sur., ComEd Ex. 46.0, 2:26-33. Staff recognizes that the ECOSS is substantially similar to the study approved in ComEd's last rate case and proposes no adjustments in this proceeding. Staff Init. Br. at 100; *see* Luth Dir., Staff Ex. 6.0, 3:21-25. Meanwhile, the AG supports ComEd's proposed residential rate design, which is based upon the ECOSS. AG Init. Br. at 79. Also, the Commercial Group recognizes ComEd's updated ECOSS is "reliable enough for setting rates" in this proceeding. CG Init. Br. at 6. In short, the record demonstrates that ComEd's proposed ECOSS provides a reasonable basis for setting rates in this proceeding.

Certain parties, however, make a number of claims suggesting that the ECOSS is flawed, thus requiring various adjustments to the study, or urging outright rejection of the study.³⁸ The

³⁸ REACT's claim that ComEd questions the ECOSS approach is a gross mischaracterization of ComEd's position. REACT Init. Br. at 26. ComEd fully supports the validity and reasonableness of the results in the updated ECOSS submitted in this proceeding. Heintz Reb., ComEd Ex. 33.0 Corr., 2:34-38; ComEd Ex. 33.1; Heintz Sur., ComEd Ex. 46.0, 1:20-2:23. In contrast, the passage REACT cites reflects the fact that ComEd generally supports a marginal approach for cost allocation purposes, but has only submitted an ECOSS in this proceeding in order to

purpose of these claims is twofold: (1) they seek to invalidate the ECOSS in an effort to avoid paying their fair share of costs, in the hopes of an across-the-board revenue allocation; or (2) to shift the burden of cost recovery to other customers, to the greatest extent possible. Heintz Reb., ComEd Ex. 33.0 Corr., 14:291-94; Crumrine Reb., ComEd Ex. 30.0, 44:993-94. The most notable example of this effort to shift costs is the proposal of IIEC. Adopting its minimum distribution system (“MDS”) approach and primary/secondary split proposal would result in \$274 million in costs being shifted from nonresidential customers to residential customers.³⁹ IIEC Ex. 5.1 Corr. The result would be a 55% increase in proposed distribution rates for residential customers, as opposed to the 24% increase proposed by ComEd. Alongi, Tr. 2246:12 - 2247:1. Interestingly, none of the proponents of the MDS approach or the primary/secondary split proposal address this economic result in their briefs. Indeed, the “tug of war” between customer classes, as described in ComEd’s Initial Brief, is reflected clearly in the disparate positions found in the parties’ briefs. ComEd Init. Br. at 91; Heintz Reb., ComEd Ex. 33.0 Corr., 14:300-02; Heintz Sur., ComEd Ex. 46.0, 3:52-60; IIEC Init. Br. at 70-76 (advocating MDS approach); City Init. Br. at 23-24 (advocating average and peak concept); CG Init. Br. at 7 (advocating differentiation of primary and secondary voltage level costs); DOE Init. Br. at 4 (same); IIEC Init. Br. at 63-69 (same).

Rather than proposing a cost study that purposefully seeks to shift costs to particular customers, ComEd’s ECOSS is consistent with similar studies previously approved, allocates

(cont’d)

limit the issues. ComEd’s testimony in this proceeding does not question the validity or reasonableness of the results of the ECOSS. Crumrine Dir., ComEd Ex. 11.0 Corr., 7:148-8:157. ComEd’s use of an ECOSS for purposes of cost allocation is consistent with prior Commission Orders requiring the use of an ECOSS. Heintz Sur., ComEd Ex. 46.0, 2:26-33.

³⁹ CTA and METRA also support both of these IIEC proposals, and the corresponding shift in the burden of cost recovery to residential customers. CTA Init. Br. at 17-25; METRA Init. Br. at 15-24.

costs in a reasonable and appropriate manner, and its results are in line with prior studies. Accordingly, ComEd urges the Commission to approve its updated ECOSS.

B. Uncontested Issues

REACT makes three claims concerning purported “uncontested” issues relating to cost of service and allocation issues.⁴⁰

1. Cost Causer Should Pay Cost

ComEd agrees that, in general, a cost causer should pay its costs. Donnelly, Tr. 540:3-9. REACT gives lip service to this principle, but actually attempts to twist it for its own economic gain. As discussed in Section VIII.F, *infra*, REACT’s claims concerning allocation of costs between the distribution and supply functions are erroneous and should be rejected. Unlike REACT, ComEd has followed the Commission’s long-standing cost-causation principles and has presented a valid cost study that properly allocates distribution-related costs among the customer classes.⁴¹

2. Identifying Cross-Subsidies Requires a Valid Cost Study

ComEd agrees that rates should be set using a valid cost study. Heintz Dir., ComEd Ex. 13.0 Corr., 1:12-16. To that end, ComEd has presented a valid ECOSS, consistent with similar studies accepted by the Commission in the last three rate cases. *Id.* at 1:20 – 2:30. Heintz Sur., ComEd Ex. 46.0, 2:26-33; ComEd Ex. 33.1. Indeed, the results of the current ECOSS are consistent with prior studies. Staff recognizes that the ECOSS is substantially similar to the

⁴⁰ It is impossible to determine which, if any, members of REACT support any of the claims set forth in Sections VIII or IX of its brief, as REACT’s brief admits that the positions stated therein “do not necessarily represent the positions of any particular member of REACT.” REACT Init. Br. at 1, fn 1. Consequently, it is unclear whether any particular ComEd customer or RES actually supports any of REACT’s positions.

⁴¹ In addition, ComEd notes that this issue is not, strictly speaking, uncontested, as the CTA and METRA explicitly seek to avoid paying their cost of service. *See* Section IX.C.2.b.ii.

study approved in ComEd’s last rate case and proposes no adjustments in this proceeding. Staff Init. Br. at 100; *see* Luth Dir., Staff Ex. 6.0, 3:21-25. Moreover, the Commercial Group notes that the ECOSS is “reliable enough for setting rates” in this proceeding. CG Init. Br. at 6. REACT, however, seeks to invalidate the ECOSS in order to preserve or exacerbate its existing subsidies, which are borne by other customers. As discussed below, REACT’s claims are self-serving and wrong.

3. Customer-Specific Cost of Service Studies Are Not Practical Or Appropriate

REACT trumpets the claim that customer-specific cost studies are “feasible.” REACT Init. Br. at 23. The Chicago Cubs winning 162 (or even 160) games in a season also is “feasible.” REACT attempts to make the Commission believe that conducting such studies is a simple exercise. *Id.* at 23-24. In reality, the evidence demonstrates that the development of a customer-specific cost study is an inordinately complex exercise, which is neither practical nor appropriate. This argument is discussed in Section VIII.C.5.

C. Embedded Cost of Service Study Issues

1. Appropriate Study

a. ComEd’s Updated ECOSS Should Be Used To Set Rates

ComEd’s updated ECOSS is the appropriate study upon which to set rates. Heintz Sur., ComEd Ex. 46.0, 1:20-2:23; CG Init. Br. at 6; AG Init. Br. at 79. The Commission previously has rejected many of the suggested modifications to the ECOSS and the record fails to support those proposals in this proceeding—*i.e.*, the MDS and A&P proposals. Heintz Reb., ComEd Ex. 33.0 Corr., 14:291-307. Indeed, those parties that claim the ECOSS is fatally flawed because it does not adopt the MDS approach ignore the Commission’s Order in ComEd’s last rate case. In

rejecting requests that ComEd be ordered to include an MDS approach in the ECOSS in its next rate case, the Commission was clear:

In the Commission's view, it would be unreasonable to require ComEd to perform a COSS that incorporates a method ... that the Commission has repeatedly rejected.

Docket No. 05-0597, Order at 165 (emphasis added).

Meanwhile, proposals seeking customer-specific cost studies are impractical and far more complex than their advocates claim. ComEd Init. Br. at 96-98; *see also* Heintz, Tr. 2037: 10 - 2038:18, 2048:4 – 2057:3. Finally, the fact that the ECOSS does not consider a split for primary and secondary voltages, even assuming such a split is appropriate, does not render the study improper. Staff Init. Br. at 100; Lazare Reb., Staff Ex. 18.0, 18:402-10; CG Init. Br. at 6; Heintz Sur., ComEd Ex. 46.0, 5:101 - 6:113. In the end, the proponents of these modifications seek to ensure that they bear as little of the cost recovery burden as possible.

b. ComEd Has Demonstrated That Its Updated ECOSS Is Reasonable

The City claims that ComEd failed to meet its burden of proving that its ECOSS is just and reasonable. City Init. Br. at 24. This claim is disingenuous and completely ignores the evidentiary record. First, ComEd's ECOSS is consistent with previous studies that were filed and approved in prior ComEd rate cases. Heintz Dir., ComEd Ex. 13.0 Corr., 1:21 – 2:30, 6:120-31; Heintz Sur., ComEd Ex. 46.0, 2:26-33. Indeed, ComEd has presented substantial testimony and supporting evidence in support of the ECOSS and has met its burden. *See* Heintz Dir., ComEd Ex. 12.0 Corr., 6:116 – 22:476; Heintz Reb., ComEd Ex. 33.0 Corr., 1:10 – 17:370; Heintz Sur., ComEd Ex. 46.0, 1:12 – 12:249; Alongi/Jones Dir., ComEd Ex. 12.0, 24:416 - 27:498; Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 4:66 - 40:647; Alongi/Jones Sur., ComEd Ex. 45.0, 3:55 - 20:401; Crumrine Dir., ComEd Ex. 11.0 Corr., 7:145 - 8:164; Crumrine Reb.,

ComEd Ex. 30.0, 43:958 - 53:1193; Crumrine Sur., ComEd Ex. 43.0 Corr., 30:648 - 33:719. Second, ComEd was under no obligation to file an ECOSS with any of the suggested modifications now offered in this record. ComEd's not including the various modifications to the ECOSS now suggested in this proceeding does not mean that ComEd has failed to meet its burden of proof. In reality, the burden is on the City and other parties to prove that their oft-rejected proposed modifications to the ECOSS are somehow appropriate in this instance. As demonstrated below, the City and other parties have failed to do so.

2. Primary/Secondary Split

Prior to this rate case, ComEd has filed, and the Commission has approved, three separate ECOSSs. ICC Docket Nos. 99-0117, 01-0423, and 05-0597.⁴² None of those accepted studies have included a primary/secondary split. That is, none of the three separately allocated to customers the costs associated with primary voltage (> 4 kV) distribution facilities and the costs of secondary voltage (< 4 kV) distribution facilities. Yet, various Intervenors now claim that the proposed ECOSS is flawed because it does not contain such a differentiation. IIEC Init. Br. at 63-70; DOE Init. Br. at 4-5⁴³; Nucor Init. Br. at 7-11; CG Init. Br. at 7; METRA Init. Br. at 15-20; CTA Init. Br. at 17-22; REACT Init. Br. at 29-31.

⁴² Some parties claim that the Commission did not accept the ECOSS in each of ComEd's last three rate cases. *See, e.g.*, IIEC Init. Br. at 60; REACT Init. Br. at 28. They are wrong. These parties must make these claims, otherwise their attempts to invalidate the ECOSS in this proceeding cannot stand. As explained in the testimony of various ComEd witnesses, the Commission did, in fact, accept ComEd's three previous ECOSSs. Heintz Dir., ComEd Ex. 13.0 Corr., 6:120-31; Crumrine Reb., ComEd Ex. 30.0, 43:977 - 44:980, 48:1073-88; Crumrine Sur., ComEd Ex. 43.0 Corr., 31:670-74; Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 13:173-90. Indeed, Staff agrees. Staff Init. Br. at 100.

⁴³ ComEd objects to pages 5-10 of DOE's initial brief and respectfully requests that it be stricken. These pages are the equivalent of impermissible direct testimony. Starting on page 5 the brief asks the reader to assume a hypothetical. Going through page 10, the brief continues its discussion of this hypothetical. There is no citation to the record, and there can't be, as this hypothetical does not exist in the evidentiary record.

The Intervenors' claims on this point first must be placed in perspective. Only a small number (less than 1%) of ComEd customers take service at primary voltage, as IIEC concedes. Stowe Dir., IIEC Ex. 3.0 Corr., 14:239-40; IIEC Init. Br. at 63. Thus, only a tiny fraction of ComEd's customers do not utilize secondary system facilities. Heintz Reb., ComEd Ex. 33.0 Corr., 3:64 - 4:65. Moreover, ComEd does not keep its books in a manner that would facilitate changing the ECOSS to recognize the primary/secondary distinction. Heintz Reb., ComEd Ex. 33.0 Corr., 3:60-64. While Intervenors seek this change, they offer no comparison between the benefits that might accrue to a tiny fraction of ComEd's customers, and the costs involved if ComEd is required to revise its books to accommodate this proposal. *Id.* at 4:66-68.

IIEC's attempted calculation of the impacts of a primary/secondary split is inappropriate and should be rejected. As ComEd witness Heintz described, Mr. Stowe's analysis suffers from the same lack of data that has prevented ComEd from including a primary/secondary distinction in the ECOSS. Heintz Reb., ComEd Ex. 33.0 Corr., 4:71-73. For actual data, Mr. Stowe substitutes guesstimates based on data he obtained from ComEd that he claims represents the purchases of overhead and underground wires for the five year period 2002-2006. *Id.* at 73-75. In addition, Mr. Stowe fails to address how his analysis could approximate the net plant split between primary and secondary. *Id.* at 76-77.

The Commission should reject Intervenor arguments supporting the proposed inclusion of a primary/secondary split in the ECOSS for the reasons stated above. In addition to being problematic, adopting this proposal likely will lead to a shift of costs to residential and small business customers. Heintz Sur., ComEd Ex. 46.0, 5:111 - 6:113. However, in the event the Commission believes a primary/secondary split of distribution lines is appropriate, ComEd proposes: (1) that the Commission Order that such a split be included in ComEd's next filed

ECOSS; and (2) that the Commission approve the current updated ECOSS as proposed, because requiring a primary/secondary split is simply a refinement to an ECOSS structure that has been repeatedly accepted. ComEd Init. Br. at 93; Staff Init. Br. at 100.

Finally, as for claimed economic impacts resulting from the absence of a primary/secondary split in the current ECOSS, the record is clear. ComEd's rate mitigation proposal for the Extra Large, High Voltage and Railroad class customers results in rates that would not exceed those rates resulting from Mr. Stowe's flawed and biased method. Alongi/Jones Sur., ComEd Ex. 45.0, 4:77-86.

3. Minimum Distribution System

a. The Commission Should Again Reject the MDS Proposal and Its Proponents' Attempt To Shift Millions of Dollars to the Residential Classes

The Commission has rejected the MDS concept on numerous occasions in the past. ComEd Init. Br. at 94. In ComEd's last rate case the Commission stated:

Based on the record in the instant case, the Commission rejects the minimum distribution or zero-intercept approach recommended by IIEC and BOMA for purposes of allocating distribution costs between the customer and demand functions. In the Commission's view, ComEd's method is consistent with the fact that distribution systems are designed primarily to serve electric demand, and the Commission believes that attempts to separate the costs of connecting customers to the electric distribution system from the costs of serving their demand remain problematic. Furthermore, this conclusion is consistent with the decisions in Docket Nos. 99-0121 and 00-0802.

Commonwealth Edison Co., Docket No. 05-0597, Order at 165 (July 26, 2006) (emphasis added). While the Commission stated that it was willing to consider the MDS approach in future rate cases (*id.*), proponents of the MDS approach have failed to demonstrate why the Commission should diverge from its prior orders and shift tens of millions of dollars in cost

recovery burden to residential customers. IIEC Init. Br. at 70-76; METRA Init. Br. at 20-24; CTA Init. Br. at 22-25.

IIEC claims that it has presented new information in this record to support adoption of the MDS approach.⁴⁴ IIEC Init. Br. at 71-76. In particular, IIEC claims that Mr. Stowe has demonstrated “for the first time” that a portion of ComEd’s distribution system is designed to meet specific safety and reliability standards imposed by the Commission, namely the National Electric Safety Code (“NESC”) standards, as reflected in 83 Ill. Adm. Code 305.20(b). *Id.* at 72, 75. IIEC further claims that the cost to meet these standards “var[ies] with the number of customers on the utility’s system, not customer demand.” *Id.* at 75. Accordingly, IIEC urges the Commission to adopt Mr. Stowe’s arbitrary allocation of such costs within his proposed MDS approach. *Id.* at 73. The record, however, fails to support Mr. Stowe’s MDS proposal.

Mr. Heintz presented the ECOSS in this case and also explained why the MDS approach continues to be inappropriate. Heintz Reb., ComEd Ex 33.0 Corr., 4:80-6:111. Mr. Heintz has extensive experience in addressing cost of service issues, both in Illinois and before the Federal Energy Regulatory Commission (“FERC”). Heintz Dir., ComEd Ex. 13.0 Corr., 2:35-5:101. He has presented, and the Commission has accepted, the ECOSS in ComEd’s last three rate cases *Id.* at 4:71-78; Heintz Sur., ComEd Ex. 46.0, 2:26-33. Mr. Heintz testified that the MDS is an entirely theoretical, non-cost-based method for allocating costs. Heintz Reb., ComEd Ex. 33.0 Corr., 14: 291-92. He pointed out that the costs in distribution plant accounts 364 - 367, where not directly assigned, are properly allocated to customer classes, not individual customers, on non-coincident peak or coincident peak demands. *Id.* at 4:83-87. The basis for allocating these

⁴⁴ ComEd addresses IIEC’s arguments concerning the MDS approach, as CTA and METRA each cite to IIEC witness Stowe’s testimony in support of their positions on MDS. CTA Init. Br. at 22-25; METRA Init. Br. at 20-24.

costs among customer classes is straightforward: “demands are the primary factor causing cost incurrence.” *Id.* at 4:87. Put another way, it is demand, not the existence of certain safety rules, which is the primary driver for the costs being allocated from FERC Accounts 364 -367.

This is precisely the reason why the Commission rejected the MDS proposal in the last rate case: “distribution systems are designed primarily to serve electric demand, and the Commission believes that attempts to separate the costs of connecting customers to the electric distribution system from the costs of serving their demand remain problematic.” *Commonwealth Edison Co.*, Docket No. 05-0597, Order at 165 (July 26, 2006). IIEC has not solved this “problem”. These same safety codes upon which IIEC now relies were in existence the last time the Commission rejected the MDS approach. Yet, IIEC assumes that the Commission was unaware of this fact the last time it rejected the MDS approach. It is clear that demand remains the primary driver for these costs.

ComEd is not alone in its opposition to IIEC’s position. Staff rejects Mr. Stowe’s proposal as it “is clearly misguided because it improperly allocates on a customer basis distribution level costs that are appropriately considered demand-related.” Staff Init. Br. at 100; Lazare Reb., Staff Ex. 18.0, 17:393 - 18:400. The AG rejects this proposal as well, as it improperly shifts costs to residential customers. AG Init. Br. at 79-80. For the foregoing reasons, the Commission should reject IIEC’s proposed MDS approach.

4. Average and Peak Methodology

The Commission should reject the City’s proposal that the ECOSS include the average and peak (“A&P”) concept. City Init. Br. at 23-24. The Commission has rejected similar A&P proposals for electric utilities on a number of occasions and should do so again here. ComEd Init. Br. at 95-96. The A&P allocation method is based on a non-empirical theory, and is not

justified by, or reliant upon, ComEd's booked, embedded costs. Heintz Reb., ComEd Ex. 33.0 Corr., 13:278-80. The City does not dispute this fact. In contrast, ComEd's ECOSS is not grounded on speculative and debatable allocation theories, it is grounded on the costs set forth in ComEd's books. *Id.* at 14:299-300. In past dockets, the Commission has refused to require changes in ComEd's ECOSS that are not supported by ComEd's actual costs. *Id.* at 14:302-07. ComEd urges the Commission to continue that policy in this proceeding.⁴⁵

The proposal also highlights the schizophrenic nature of Mr. Bodmer's two pieces of testimony. Heintz Reb., ComEd Ex. 33.0 Corr., 15:311-16. The A&P method will shift costs away from residential customers to nonresidential customers. Bodmer Dir., City Ex. 1.0 Corr., 75:1374-80. Meanwhile, despite its rhetoric about the virtues of setting rates based on cost, REACT says nothing about this improper shifting of costs to nonresidential customers. The reason is simple: to do so would be to criticize its own witness, the same Mr. Bodmer. What this does demonstrate, however, is that REACT's cost causation claims are illusory. In the end, REACT seeks to maintain its rate subsidies.

5. Customer-Specific Cost of Service Study Recommendations

a. Claims for Customer-Specific Cost Studies Should Be Rejected

ComEd's assignment of costs on the basis of delivery class attributes for all delivery classes remains the more practical and less costly method to employ in developing the assignment of costs in the ECOSS. Heintz Sur., ComEd Ex. 46.0, 4:69-70, 81-83. Indeed, the Commission has historically relied on the use of such studies for setting rates for all customer

⁴⁵ Consistent with the "tug of war" between residential and nonresidential customers, various nonresidential customers also oppose the City's proposal to adopt A&P concept. CG Init. Br. at 8; IIEC Init. Br. at 76-78; Kroger Init. Br. at 4-5.

classes. CTA and METRA urge the Commission to order customer-specific cost studies for the two members of the Railroad Class, while REACT, through the testimony of its witness, Mr. Bodmer, also demands such studies for the 79 over-10 MW customers.⁴⁶ CTA Init. Br. at 25-26; METRA Init. Br. at 24-25; REACT Init. Br. at 31-33. Each of these parties claims that such a study is possible, and that such studies are more accurate than the ECOSS. CTA Init. Br. at 25-26; METRA Init. Br. at 24-25; REACT Init. Br. at 31-35. Moreover, these parties would lead the Commission to believe that such studies are easily accomplished. CTA, METRA and REACT, however, fail to cite to even one instance where the Commission has embraced the use of customer-specific cost studies for the purpose of setting rates.

The evidence demonstrates convincingly that such studies are an inordinately complex undertaking, and are impractical and inappropriate for a number of reasons. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 17:261-79; Heintz Sur., ComEd Ex. 46.0, 3:61 - 5:97; Heintz, Tr. 2037:10 – 2038:18, 2047:16 – 2057:3. The complexity of the undertaking can be illustrated using the two railroad customers as an example. While just two customers, the CTA and METRA have over 70 individual, noncontiguous traction power locations served by ComEd distribution facilities. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 17:265-67. Thus, ComEd would have to conduct more than 70 cost studies just for these two customers.⁴⁷ To accomplish this “simple” task, ComEd would have to identify each individual component of the distribution system providing service to that particular point of service, and determine the cost for each component part. Put another way, ComEd would have to start at the meter for each point of

⁴⁶ Notably, IIEC, who has members with demands over-10MW, did not file testimony supporting this position, nor did its brief argue in support of this proposal. IIEC Init. Br. at 78.

⁴⁷ The same issue exists with the 79 over-10 MW customers. Many of these customers have multiple points of service as well. Consequently, rather than 81 studies, as REACT, CTA and METRA would have the Commission believe, this proposal likely will require hundreds or thousands of such studies.

service and work back all the way to the transmission substation, identifying and costing each piece of equipment (or the portion of each piece of equipment) used to provide service to that particular location—equipment such as individual poles, wires, cross-arms, breakers, etc. *Id.* at 17:263-64. In various instances, the transmission substation may be miles away from the meter. *Id.* at 17:269-71. In addition, because of the high demands of the Railroads and Extra Large Load customers, it is often necessary to provide service from multiple feeder lines in the distribution system. *Id.* at 17:267-69. This means that ComEd would have to analyze the equipment and costs for multiple lines, possibly spanning miles from the meter, just for one point of service. Of course, not only would ComEd be required to determine the cost of the equipment being used, it would then be required to determine the operating and maintenance expenses associated with these facilities. *Id.* at 17:271-74.

The proposal for customer-specific cost studies also ignores that ComEd does not record its costs to provide distribution-related services in a manner that would enable it to directly assign the investment costs incurred to serve these customers. *Alongi/Jones Reb., ComEd Ex. 32.0 Corr.*, at 17:261-63. Given this fact, and the complexity and enormity of the exercise described above, it is unreasonable to conclude that ComEd would be able to directly assign to these customers the portion of the investment or operating and maintenance costs incurred to serve them from the wide reaching distribution system. *Id.* at 17:271-74. The record clearly supports ComEd's position that customer-specific cost studies would be a complex, time-consuming and costly exercise.

Customer-specific cost studies also are impractical and inappropriate. *Heintz Sur., ComEd Ex. 46.0*, 4:68-69. Costs to serve customers do not remain static. *Id.* at 4:70-71. For example, a cost assignment based upon a specific 30 year old transformer in place at a

customer's premises becomes understated in the event the transformer is replaced and new costs are incurred. *Id.* at 4:71-73. Likewise, operating and maintenance expenses for an individual customer in any group can vary dramatically from customer to customer. *Id.* at 4:73-75. In short, even if specific cost studies could be reasonably accomplished for these customers, intra-class subsidies would remain. *Id.* at 4:75-78. And, inevitably, one or more customers are going to object to the result of these studies, resulting in the Commission possibly having to adjudicate the reasonableness of multiple studies instead of just an ECOSS. *Id.* at 4:87-5:94. For the foregoing reasons, the Commission should reject this proposal.

b. The City's Request to Audit Street Lighting is Baseless And Should Be Rejected

The City wrongly claims that the ECOSS must be revamped because it contains incorrect assumptions and contains numerous errors. City Init. Br. at 22-23. Based on these claimed infirmities, the City recommends an audit to determine the cost of service for the City's street lighting account. *Id.* The information upon which the City relies is incorrect, and its proposal should be rejected.

The underpinning of the City's proposal is Mr. Bodmer's incorrect assumption that the City owns all the poles and secondary lines for its dusk to dawn street lighting system. Bodmer Dir., City Ex. 1.0 Corr., 81:1486 - 82:1489. In fact, thousands of City street lights are mounted on thousands of ComEd poles and are served by many miles of ComEd secondary lines throughout the City's alleys. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 18:283-86. The City did not respond to this fact in rebuttal testimony, which is reflected by the fact the City's brief only cites to Mr. Bodmer's direct testimony to support its claim. City Init. Br. at 22-23. In short, the City's claim is baseless. ComEd incurs substantial costs in providing street lighting service to the City, as reflected in the ECOSS, and the City has provided no credible evidence which

warrants an audit of the costs of providing street lighting service. Accordingly, the City's proposal must be rejected.

6. City ECOSS Issues⁴⁸

In addition to its A&P and street lighting proposals, the City makes several other claims concerning ComEd's ECOSS. City Init. Br. at 5-22. These claims rely on the testimony of Mr. Bodmer, in his one role as a City witness. Mr. Bodmer's proposals, all of which relate to residential customers, suffer from a variety of errors and incorrect assumptions and each should be rejected. Notably, no other residential consumer advocate supports the City's proposals, and neither does Staff.

a. ComEd's ECOSS Properly Allocates Costs To Single And Multi Family Customers

The City makes a number of erroneous claims concerning the manner in which ComEd allocates costs between single and multi family residential customers, each of which should be rejected. First, the City claims that the ECOSS fails to differentiate between the percentage of underground lines serving each customer group. City Init. Br. at 5. In raising this point, Mr. Bodmer testified that ComEd's prior marginal cost studies did a better job, and that ComEd "developed tariff components on the basis of an equal percentage of marginal costs...." Bodmer Dir., City Ex. 1.0 Corr., 45:828 - 46:853. Mr. Bodmer is incorrect, as ComEd's residential rates were never set on equal percentage of marginal costs. Alongi/Jones Sur., ComEd Ex. 45.0, 19:373 – 20:391.

The City next claims that while multi-family customers represent 4.7% of ComEd's energy sales, they bear 10.6% of ComEd's total cost of service. City Init. Br. at 7. The City

⁴⁸ While not included in the ALJs' approved outline, ComEd adds this section as the City raised several ECOSS-related issues that do not fall squarely within the outline.

further states that the story is more “dire” for multi-family customers when one examines customer costs, as they bear 21% of such costs. *Id.* at 7-8. The City’s position is baseless, and fails to consider the details in the ECOSS. The proper comparison is to examine the coincident peak (“CP”), non-coincident peak (“NCP”) and the number of customers in order to properly assign distribution costs. Here, allocating 10.6% of overall costs is a reasonable weighted average of costs based on the CP (7.11%), the NCP (7.5%), and multi-family customers being 23.7% of the total. ComEd Ex. 33.1, Sch. 2b. Meanwhile, assignment of 21% of customer costs to multi-family customers is very logical given that these customers comprise 23.7% of ComEd’s total number of customers. *Id.* When properly analyzed, it is clear that ComEd’s allocation of costs to multi-family customers is reasonable.

The City next makes a series of erroneous claims regarding the energy use of single family and multi-family customers, as well as an alleged disparity in usage patterns between City and non-City residential customers. For example:

- The City claims that far more multi family customers live in the City. City Init. Br. at 10-11; Bodmer Dir., City Ex. 1.0 Corr., 4:76-85 This claim is false. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 29:513 - 30:519. When all multi-family customers are properly considered, the facts show that 53% reside in the City and 47% reside outside of the City. *Id.* at 30:519-527.
- The City claims that residential customers in the City are more efficient because they use less electricity. City Init. Br. at 8; Bodmer Dir., City Ex. 1.0 Corr., 7:110-18. This claim is baseless. A household that uses less electricity than another household does not necessarily mean that the household uses electricity more efficiently. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 30:531-32. Factors impacting efficiency include: (1) the number of people in a household; (2) the number, use and efficiency of appliances and electronic equipment; and (3) the time at which electricity is used. *Id.* at 30:532-35. Mr. Bodmer offered no reasonable response to these points, and, in fact, ultimately conceded that he really meant the level of usage, not efficiency. Bodmer, Tr. 1281:7 – 1482:2.
- The City claims that residential customers in the City use “far less” electricity than similar customers outside the City. City Init. Br. at 8. This claim also is incorrect. ComEd demonstrated that the usage of multi-family customers, regardless of location, is remarkably similar. Alongi/Jones Reb., ComEd Ex. 32.0

Corr., 31:Table R9. In fact, those City multi-family customers with space heat use, on average, 18% more electricity than similar non-City customers *Id.* at 31:548-50.

- The City equates low-use customers with low-income customers. Bodmer Dir., City Ex. 1.0 Corr., 8:135-39. This claim also was refuted through the panel testimony of Mr. Alongi and Dr. Jones. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 24:403 - 26:429, 32:559 - 34:587; Alongi/Jones Sur., ComEd Ex. 45.0, 16:325 - 17:340. Again, Mr. Bodmer offered no persuasive response in his testimony.
- The City claims that the ECOSS fails to consider customer density. City Init. Br. at 11-12. This claim also is misplaced, as Mr. Bodmer's analysis is too narrow, comparing only certain areas of the city to certain areas outside of the city. Indeed, in many areas, the residential density levels are indistinguishable. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 39:621-26.
- The City's claims about "customer installation costs" also is wrong. City Init. Br. at 19. Many activities charged to customer installations costs are for existing facilities and customer-related activities, not only new installations for new customers. As Mr. Heintz demonstrated, it appears that Mr. Bodmer is confused about the account title, and the customer installations costs that are actually included within. Heintz Sur., ComEd Ex. 46.0, 8:156 - 10:209.

Despite these identified and un rebutted errors, the City somehow claims that ComEd did not "mount a spirited defense" in support of the ECOSS. City Init. Br. at 9. In reality, ComEd presented substantial, compelling evidence demonstrating that none of Mr. Bodmer's proposals is reasonable or appropriate. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 29:513 - 39:626; Heintz Reb., ComEd Ex. 33.0 Corr., 7:135 - 13:275. The evidence in this proceeding demonstrates that ComEd's ECOSS has properly allocated costs to residential customers. Accordingly, the Commission should reject the City's claims on this point.

b. The City's Proposal To Allocate Costs Based On Supposed Regional Differences Must Be Rejected.

City witness Bodmer proposes to impose a surcharge on customers in those areas that have caused ComEd to make substantial investments in the recent past, resulting in its current request for rate relief. City Init. Br. at 13-17. While the City claims that this surcharge could be

implemented in a “five-step formula,” the City’s brief fails to recognize that Mr. Bodmer appeared to modify his proposal during cross-examination, so that only new customers in those areas experiencing “sprawl” would be assessed this surcharge. Bodmer, Tr.1492:2 – 1494:8. Indeed, Mr. Bodmer not only believes this result is fair, but he further believes that such a surcharge will “discourage[] the construction of homes and businesses that have harmful environmental impacts.” Bodmer Dir., City Ex. 1.0, 43:780-86. In this regard, he likens the paving of prairies “to the destruction of Amazonian rain forests.”⁴⁹ *Id.* Put another way, it is Mr. Bodmer’s position that imposing a surcharge on electric distribution rates, which comprises only a fraction of a customer’s total electric bill, and an infinitesimal cost when developing new property, will somehow dissuade the public from developing new property. Bodmer, Tr. 1501:10 – 1502:6. This proposal is contrary to the manner in which ComEd built its system, is poor regulatory policy and is remarkably self-serving (at least in the short run). Indeed, one wonders whether the City will maintain this position when it requires substantial infrastructure improvement in order to host the 2016 Olympics.⁵⁰ Through the panel testimony of Mr. Alongi and Dr. Jones, ComEd explained in detail why Mr. Bodmer’s proposal is improper. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 28:490 - 29:510. First, ComEd does not engineer its system based on the borders of local governmental entities. *Id.* at 29:498-99. Moreover, Mr. Bodmer’s proposal fails to recognize that most, if not all, the counties that ComEd serves have areas experiencing either expansion or gentrification, which requires the installation of new distribution facilities. *Id.* at 29:505-08. His proposal also fails to recognize that ComEd must

⁴⁹ Mr. Bodmer agreed that the illustration of a home he used in his testimony was an American Dream-like home that, along with its inhabitants, impose a so-called large carbon footprint. Bodmer, Tr. 1496:17 – 1498:4.

⁵⁰ The International Olympic Committee noted that infrastructure was one of the areas where Chicago most required improvement. *See generally* <http://chicagotribune.com/business/chi-thu-olympic-challenges-jun05.0.6918500.story>.

maintain and replace older facilities in established areas of its territory. *Id.* Because setting rates on a county-by-county basis does not allocate the actual costs of service any more directly or equitably than ComEd's proposal, the City's proposal should be rejected.

D. Rate Impact Analysis

ComEd seeks to set distribution rates on traditional cost-causation principles to ensure that all customers are paying their fair share for distribution service. *Crumrine Reb., ComEd Ex. 30.0, 45:1004-05.* ComEd's goal in this proceeding is to reasonably apportion costs using the Commission's preferred embedded cost approach to minimize inter-class rate subsidies. *Id.* at 43:970-71. ComEd's proposed rates are based on a valid and reasonable cost of service study, consistent with studies previously accepted by the Commission. *Heintz Dir., ComEd Ex. 13.0 Corr., 6:120-31; Heintz Sur., ComEd Ex. 46.0, 1:20 - 2:33; CG Init. Br. at 6.* As discussed in Section IX.B.2., ComEd is proposing a 50% movement towards cost-based distribution facilities charges ("DFC") for the Extra Large Load, High Voltage and Railroad Delivery Classes in order to mitigate the rate impact for these customers. *Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 9:137-39.* The need to mitigate the rate impact to these customers results from the substantial rate subsidies these customers have received over many years. *Crumrine Reb., ComEd Ex. 30.0, 43:977 - 44:980.*

REACT exclaims that the over-10MW customers "did not do anything to deserve such a disproportionate, massive rate increase." *REACT Init. Br. at 38.* The Commission should not be swayed by such theater. In fact, REACT witness Bodmer knew precisely why these customers were receiving this increase under ComEd's proposed rates. *Bodmer, Tr. 1536:20 – 1537:13, 1537:21 – 1543:2.* As Kroger observes, fully cost-based rates for the over-10MW customers are "still lower, for the most part, than the rates of the non-residential classes that would be burdened

with the subsidy” resulting from ComEd’s mitigation proposal. Kroger Init. Br. at 8 (emphasis added). Moreover, all parties are keenly aware that the over-10MW customers have been receiving substantial subsidies for many years. Crumrine Reb., ComEd Ex. 30.0, 43:977 - 44:980; CG Init. Br. at 6. The over-10MW customers receive \$44 million in subsidies under current rates. Crumrine Reb., ComEd Ex. 30.0, 47:1045-47. Put another way, these customers are paying only 44% of their cost of service under current rates *Id.* at 47:1049-52. This subsidy is being paid for by other nonresidential customers. *Id.* at 43:967-69.

REACT argues that ComEd’s subsidy claims are “intellectually dishonest.” REACT Init. Br. at 48. In reality, it is REACT’s position that is disingenuous. Subsidies for the over-10MW have existed since the resolution of ComEd’s rate case in Docket No. 01-0423. Crumrine Reb., ComEd Ex. 30, 43:977 - 44:980. However, one does not need to look only to ComEd to make this point. The Commercial Group states:

all CCOS studies in evidence in this case show the Medium, Large, and Very Large classes providing returns substantially above cost. Thus, there is no dispute that these classes are subsidizing the rest of the system.

CG Init. Br. at 6. (emphasis in original); *see also* Vite, Tr. 1665:6-9.

In conclusion, REACT’s claim that ComEd’s proposed rate increase for the over-10MW customers is unreasonable because the percentage increase is disproportionate with the increases for other classes is a red-herring. The reason for the difference is simple: movement towards fully cost-based rates eliminates the subsidies that these customers have been enjoying for years. Had these customers been paying cost-based rates, their percentage increases would be comparable to other nonresidential customers.

E. Interclass Allocation Issues

Interclass allocation concerns the allocation of the revenue requirement among customer classes and rate elements. *Crumrine Reb.*, ComEd Ex. 30.0, 43:962-65. This process is a zero-sum game, with the goal of allocating the revenue requirement among customer classes in a manner that is fair to customers, while allowing for full recovery of revenues. *Id.* at 43:965-67. In making decisions concerning interclass revenue allocation and rate design, ComEd must balance the interests of all customers, not just those who are likely to participate in the rate case proceeding. *Id.* at 43:973-76. If one customer class does not pay its fair share of costs, another customer class must pick up the bill, which creates subsidies. *Id.* at 43:967-69. ComEd's proposed rates limits such subsidies, while recognizing the need to mitigate rate increases for the Extra Large, High Voltage and Railroad Customer Classes.

1. Across-the-Board Increase

Under the pretense that the ECOSS is flawed, parties representing high voltage, larger demand, and railroad customers urge the Commission to adopt an across-the-board increase in rates. CTA Init. Br. at 26-27; DOE Init. Br. at 13; IIEC Init. Br. at 78-82; METRA Init. Br. at 25-26; REACT Init Br. at 41-42. For DOE, IIEC and REACT, this request is nothing more than a thinly veiled attempt to retain rate subsidies currently borne by other nonresidential customers. For the CTA and METRA, they explicitly seek to retain their existing rate subsidies premised on various public policy arguments. See Section IX.C.2.b.ii. of this Reply Brief. Meanwhile, Staff supports an across-the-board increase premised on the erroneous belief that, in this instance, it is "equitable" to do so. Staff Init. Br. at 97. Stated simply, adoption of an across-the-board allocation method for setting new rates will exacerbate existing and create new subsidies. *Crumrine Sur.*, ComEd Ex. 43.0 Corr., 32:697-701; ComEd Ex. 45.1. Application of this

mechanism is unfair to certain customers and contrary to the Commission's long-standing application of cost-causation principles. Staff admits this latter point in its Initial Brief, stating that this method:

is an alternative to using a cost of service study and revenue allocation to determine rates. If the Commission adopts an across-the-board increase ... the result would be to bypass the cost of service study and revenue allocation process.

Staff Init. Br. at 96. Use of this method would be a dramatic departure from the Commission's preference to set rates based on cost. Lazare, Tr. 1576:9-13. Staff recognizes this point, but nonetheless encourages the Commission to depart from its policy. *Id.* at 98-99. The following will address the arguments of the large customers and Staff in turn.

a. The Commission Should Reject The Attempts of Certain Large Customers To Maintain Their Current Subsidies

There is no need for the Commission to adopt an across-the-board allocation method for setting rates. The evidence demonstrates that ComEd's ECOSS reasonably allocates distribution-related costs among all customer classes, and is consistent with the studies previously accepted and the Commission's long-standing policy to set rates based on cost. Heintz Dir., 13.0 Corr., 1:20 - 2:30; Crumrine Reb., ComEd Ex. 30.0, 50:1126 - 51:1135. The Commission should continue to set rates based on cost.

Those customers seeking an across-the-board increase share a common goal: to maintain the substantial rate subsidies that they currently enjoy. Crumrine Reb., ComEd Ex. 30.0, 49:1104-08. ComEd has demonstrated that the Extra Large, High Voltage and Railroad Customer Classes have been enjoying substantial rate subsidies for years. *Id.*, at 43:977 - 44:980, 46:1031 - 47:1052. If ComEd's proposed rates are accepted, the level of subsidies that these customers now receive will be reduced, as they will have rates that move them closer to

their full cost of service. However, these parties have displayed no concern that such subsidies are borne by other nonresidential customers. CG Init. Br. at 11-12.

Their argument for the use of an across-the-board allocation method rests on one incorrect claim: that the ECOSS is so flawed that it can't be used to set rates. This assertion is false, as ComEd has demonstrated in both its Initial Brief and this Reply Brief. ComEd Init. Br. at 99-100. Indeed, other customers find the ECOSS appropriate for setting rates. CG Init. Br. at 6; AG Init. Br. at 80. Similarly, Staff also found the ECOSS to be valid, as Staff identifies the use of ComEd's mitigation proposal as an acceptable alternative to its proposals. Staff Init. Br. at 102. Meanwhile, certain of these large customers also claim that Staff found the ECOSS questionable, because of issues related to the primary/secondary split. IIEC Init. Br. at 79. This claim, however, was flatly refuted in Staff's brief. The absence of a primary/secondary split in the ECOSS:

is not a sufficient deficiency to make ComEd's cost of service study an unsuitable foundation for setting rates. It should be remembered that the Commission accepted ComEd's proposed cost of service in Docket No. 05-0597 without the distinctions between primary and secondary distribution costs advocated by IIEC. Thus, the Commission may not consider this failure to distinguish between primary and secondary costs a sufficient reason to reject the Company's study as a ratemaking tool.

Staff Init. Br. at 100 (citation omitted). In fact, Staff's support of the across-the-board approach has nothing to do with the validity of the cost study. *Id.* at 96-101. Given that the ECOSS is reasonable and can be used to set rates in this proceeding, the proposal to use an across-the-board allocation method for setting rates should be rejected.

b. Staff's Rationale For An Across-the-Board Rate Increase Is Flawed

Staff's proposal to use an across-the-board allocation method for setting rates is founded on its concern about "bill impacts." Staff Init. Br. at 96-101. Staff is concerned that "ComEd

ratepayers have been financially stressed by significant increases in electricity costs that may very well continue for the foreseeable future.” *Id.* at 96-97. Consequently, by increasing rates on an across-the-board approach, “equal recognition is given to all ComEd ratepayers of the difficulties bill impacts present.” *Id.* at 98. Indeed, if rates were set on an unequal basis, Staff believes that that “may create feelings of unfairness among ratepayers who receive above average increases.” *Id.* Surprisingly, Staff does not limit its proposal to only this case, but instead leaves it as the preferred approach for an indefinite period of time stating:

[u]ntil some degree of rate stability returns, the design of ComEd rates should be based on bill impacts rather than cost of service.

Id. at 99 (emphasis added).

Adopting Staff’s equal percentage across-the-board approach is not neutral to customers. Alongi/Jones Sur., ComEd Ex. 45.0, 8:136 – 9:155. This approach will result not only in the continuation of rate subsidies for customers in the Extra Large, High Voltage and Railroad Customer Classes, it will exacerbate those subsidies. *Id.* at 8:138-9:155. Moreover, this approach will create new subsidies, shifting approximately \$33 million from the residential sector to small and medium nonresidential and street lighting customers. Crumrine Sur., ComEd Ex. 43.0 Corr., 32: 697-701; Alongi/Jones Sur., ComEd Ex. 45.0, 10: 170-77; ComEd Ex. 45.1. Staff does not, and cannot, rebut this point.

In fact, Staff’s proposal would harm certain customers, subjecting them to increases that exceed the increase in the costs to serve them. Alongi/Jones Sur., ComEd Ex. 45.0, 9:161-63. Undoubtedly, this result would, and has, created the “feelings of unfairness” that Staff seeks to avoid. For example, these “feelings” are reflected in the briefs of the Commercial Group, who does not wish to continue paying for existing subsidies, or start paying for new subsidies. CG Init. Br. at 8-12. Given that Staff seeks to impose this methodology indefinitely, those subsidies

will continue to grow, making it even more difficult to move all customers to fully cost-based rates in the future. Accordingly, the Commission should reject using the across-the-board allocation method in this proceeding.

2. Other Rate Moderation/Mitigation Proposals

ComEd's proposed rates incorporate a rate moderation proposal for the Extra Large, High Voltage and Railroad Customer Classes. This proposal is cost-based, using ComEd's proposed ECOSS, and moves these customer classes closer to cost. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 9:137-46. This proposal also serves to reduce the size of the subsidy being borne by other nonresidential customers. Finally, ComEd's proposal also is consistent with the Commission's long-standing policy of setting rates based on cost. Lazare, Tr. 1576:9-13. In short, the evidence supports using ComEd's rate moderation proposal to set rates.

As alternatives to setting rates on a non-cost-based across-the-board allocation approach, several parties offer their own mitigation proposals based on ComEd's ECOSS. IIEC Init. Br. at 82; DOE Init. Br. at 14. And, Staff also identifies ComEd's rate proposal as a viable alternative should the Commission seek to base rates on cost. Staff Init. Br. at 102. While not ideal, ComEd submits that IIEC's and DOE's alternative proposals are a step in the right direction, as they are cost-based and move the Extra Large, High Voltage and Railroad Customer Classes towards a fully cost-based rate. In the end, setting rates on a cost-based rationale is far superior to the across-the-board allocation approach.

Meanwhile, various parties reject any cost-based rate moderation/mitigation proposal. These parties can be divided into two camps: (1) those who do not want to continue to subsidize the rates of other customers (CG Init. Br. at 11-12; Kroger Init. Br. at 8-9); and (2) those who are interested only in maintaining their existing subsidies. CTA Init. Br. at 27-28; REACT Init. Br.

at 42-47. ComEd understands the concerns of the Commercial Group and Kroger, which is why ComEd supports moving the Extra Large, High Voltage and Railroad Customer Classes rates towards costs. While not perfect, ComEd's proposal is preferable to the across-the-board allocation method. Meanwhile, nothing supports those parties interested only in maintaining or increasing their current level of rate subsidization.

Staff also offers, and others support, another alternative proposal: average the DFC for Medium Load, Large Load, Very Large Load, Extra Large Load and High Voltage (Other) customers so that each would pay the same DFC per kW of demand, \$5.85.⁵¹ Staff Init. Br. at 101-02. This proposal should not be adopted. First, under the updated ECOSS, it no longer makes sense to have a weighted DFC that includes the subclass of the High Voltage Delivery Class for customers with demand at or below 10,000 kW. Alongi/Jones Sur., ComEd Ex. 45.0, 10:186-88. Indeed the bill impacts for these customers would be far greater than under ComEd's rate moderation proposal. *Id.* at 188-92.

Finally, as an alternative the CTA and METRA seek their own, non-cost-based rate proposal: to limit the Railroad Class increase to the lesser of the overall system increase or the increase given to residential customers. CTA Init. Br. at 27-28. The Commission should reject this proposal for what it is: an unabashed attempt to maintain existing subsidies, at the expense of other ratepayers.

⁵¹ Kroger supports this particular rate proposal from Staff. Kroger Init. Br. at 1.

F. Supply vs. Delivery Services Allocation Issues

REACT asks the Commission to carve out \$64.9 million of so-called “Customer Care” costs from ComEd’s delivery service rates and reallocate these costs to ComEd’s supply rates.⁵² This request should be rejected for four reasons. First, it is inconsistent with prior Commission Orders. Second, the adjustment is based on assumptions, not evidence. Third, as a matter of policy, the adjustment will unfairly penalize customers that decide to take supply from ComEd. Finally, REACT’s hyperbolic rhetoric regarding retail competition is utterly contrary to the record.

1. REACT’s Proposal Is Contrary To The Commission’s Recent Orders On This Issue

REACT’s proposal to shift nearly \$65 million of Customer Care costs to supply rates directly conflicts with recent Commission decisions. REACT claims that ComEd has misallocated its delivery service-related costs in an attempt to subsidize its supply rate. REACT Init. Br. at 50. As such, it proposes that ComEd recover such costs through its supply cost rider, Rider PE. Merola, Tr. 1908:17-21. Not only is REACT’s proposal meritless, Staff and the Commission have flatly refuted this characterization of ComEd’s intent. ComEd has appropriately allocated these costs to its delivery function, and has done so consistent with recent Commission orders that addressed this very question.

The most recent Commission Order involved ComEd’s proposed procurement plan and related supply tariffs. *Commonwealth Edison Co.*, Docket Nos. 07-0528/07-0531 (Cons.) (Dec. 19, 2007). In that proceeding, rather than being concerned that ComEd’s supply rate was too

⁵² This proposal also is supported by the Commercial Group. CG Init. Br. at 12-13. The Commercial Group cites to a single transcript passage, which has no bearing on the real issue – whether customer costs vary with kWh sales, which they do not.

low, as REACT suggests now, Staff was very concerned that ComEd's proposed procurement tariff would create an inappropriate incentive to inflate the supply rate. Staff expressly argued that ComEd's proposed procurement tariff would allow for the improper recovery of administrative costs through proposed Rider PE, which would be inconsistent with Section 16-111.5(l) of the Act. *Id.*; *Commonwealth Edison Co.*, Docket No. 07-0531, Staff Reply Comments at 11. Accordingly, Staff argued to limit the scope of the supply tariff, Rider PE, to recover only those administrative costs that directly result from ComEd's discharge of its supply responsibilities, but not common costs that might otherwise be allocable to supply. The Commission noted Staff's concern about ComEd's proposed tariff in its Order stating that:

Staff asserts that there is an incentive for ComEd to classify common costs as costs attributable to procuring power supply.

Commonwealth Edison Co., Docket Nos. 07-0528/07-0531 (Cons.), Order at 104 (Dec. 12, 2007).

In response to Staff's concerns, ComEd amended its proposed tariffs, stating:

...ComEd makes clear that the internal and administrative costs that will flow through the rider are those incurred solely as a result of ComEd meeting its statutory procurement obligation. For example, ComEd would not recover in the rider either the costs of employees who are not devoted to procurement functions or allocated overhead costs.

Commonwealth Edison Co., Docket No. 07-0531, ComEd Reply Comments at 10 (emphasis added). The Commission approved the revised proposed tariffs with these limitations. *Commonwealth Edison Co.*, Docket No. 07-0528/07-0531 (Cons.), (Order, Dec. 19, 2007) at 105.

The Commission's Order employed a narrow reading of Section 16.111.5(l) when determining what costs were appropriately recovered through ComEd's Rider PE. Contrary to REACT's claims, the facts demonstrate that Staff and the Commission have been concerned with

the negative effects of inappropriately inflating ComEd's supply rate. As such, REACT's attempt to flow these so-called Customer Care costs through Rider PE is in direct conflict with the concerns of Staff and the decision of the Commission. Clearly, REACT's claims about ComEd's intent with regard to the allocation of so-called Customer Care costs are baseless and should be rejected. The Commission, having decided this issue only a few months ago, should not now reverse course and allocate these costs to supply rates based on faulty assumptions, which have no demonstrated relationship to ComEd.⁵³ See Section VIII.F.2, *infra*.

The recently decided procurement dockets were not the first time that the Commission considered the proper allocation of administrative costs as between ComEd's delivery service and supply rates. In ComEd's last rate case, the Commission also addressed an almost identical proposal to that now asserted by REACT. There, the Commission expressly rejected arguments "to allocate no less than one-fourth of call center costs to supply." *Commonwealth Edison Co.*, Docket No. 05-0597, Order at 257 (July 26, 2006). Moreover, in yet another prior rate case, the Commission approved ComEd's allocation of delivery-related expenses to delivery rates, which allocated these so-called Customer Care costs to delivery service rates. *Commonwealth Edison Co.*, Docket No. 01-0423, Interim Order at 62-63 (April 1, 2002); Final Order at 71-72 (March 28, 2003). REACT's proposed carve out of so-called Customer Care costs would require the Commission to reverse a number of decisions that have found ComEd's allocation of delivery service-related costs to be reasonable. REACT has presented nothing that would support this abrupt reversal of prior orders.

⁵³ ComEd notes that no party objected to its proposed allocation of so-called Customer Care costs in their direct testimony. Rather, REACT presented this claim for the first time in its rebuttal testimony.

2. REACT's Proposal Is Premised On A Series of Unreasonable And Arbitrary Assumptions.

REACT's proposal to carve out \$64.9 million of delivery service costs that it calls "Customer Care costs" is unreasonable and rests solely on a series of arbitrary assumptions. Merola Reb., REACT Ex. 7.0, 13:287 - 22:485. Moreover, the proposal is contrary to the definition of "delivery services" as set forth in the Act, which includes billing and standard metering services, and which allows for the recovery of such costs in delivery service rates 220 ILCS 5/16-102, 16-108; ComEd Init. Br. at 119. ComEd has appropriately allocated its Customer Care costs to its delivery function, and has done so in a manner consistent with prior Commission-approved allocations for such costs. See Section VIII.F.1, *supra*.

REACT makes several claims in an attempt to support this proposed re-allocation, none of which are persuasive. First, it points to ComEd witness Crumrine's testimony where he stated that while 0% of its Customer Care costs are allocated to supply, it is not "absolute zero." REACT Init. Br. at 52. Mr. Crumrine's statement does not undermine ComEd's position, as REACT claims. To the contrary, Mr. Crumrine underscores the fact that virtually all Customer Care costs are related to ComEd's delivery function.

Indeed, REACT failed to prove that any Customer Care costs would be avoided "if all customers served under Rate BES migrated to alternative suppliers." Crumrine Sur., ComEd Ex. 43.0 Corr., 34:740-42. Put another way, ComEd would continue to incur these Customer Care costs to serve these customers as part of its delivery function. The costs that REACT seeks to allocate to supply are not costs that vary with the amount of kWhs supplied by ComEd. Allocating any of ComEd's costs to supply should be limited to those costs that actually are reduced when ComEd no longer provides supply to customers. Energy losses and uncollectible costs are prime examples of costs that already are assigned to supply, because they are costs that

ComEd no longer incurs when a customer chooses to take supply from an alternative supplier. For example, ComEd has allocated a portion of Customer Records and Collection Expense (Account 903), \$112,483, to its supply function. Allocating costs to supply, when those costs do not change as customers leave ComEd's supply, only serves to arbitrarily increase the supply price and distort appropriate price signals.

REACT next complains that ComEd did not allocate shared service costs to the supply function. REACT Init. Br. at 52. REACT is wrong. ComEd's Initial Brief identifies the evidence and explains the rationale for its allocation of shared service costs. ComEd Init. Br. at 117-19.

REACT then argues that its witness has established the existence of supply-related Customer Care costs in ComEd's delivery rates and urges the Commission to adopt Mr. Merola's flawed analysis. REACT Init. Br. at 53-55. In reality, Mr. Merola failed to prove that actual supply-related Customer Care costs are currently residing in ComEd's proposed delivery rates. Rather, he assumes that supply-related costs must be included, because of his experience in examining other out-of-state utilities. However, he fails to explain the methodology used, or the approach taken in those states, to determine the existence of such supply-related costs. Crumrine Sur., ComEd Ex. 43.0 Corr., 34:743-48. Moreover, he fails to explain how those methodologies or approaches might be applicable to ComEd. *Id.*

Once he assumed that supply-related Customer Care costs exist in ComEd's delivery rates, Mr. Merola then arrived at his 40% allocation figure based upon a series of additional assumptions, as he admitted during cross-examination. Merola, Tr. 1899:10 - 1906:9. His assumptions have no relation to ComEd's actual Customer Care costs. Crumrine Sur., ComEd Ex. 43.0 Corr., 34:737-42. Moreover, small variations in his assumptions can lead to dramatic

fluctuations in his proposed re-allocation percentage. Indeed, in testing the sensitivity of the result to his assumptions, one modest adjustment to Mr. Merola's assumptions would reduce the proposed adjustment from \$64.9 million to \$19.5 million. Merola, Tr. 1905:21 - 1907:15. In short, REACT asks the Commission to re-allocate \$64.9 million in costs to the supply function based upon a myriad of assumptions, none of which has been shown to be applicable to ComEd. Accordingly, as it did in ComEd's last rate case, the Commission should again reject the attempt to shift delivery-related Customer Care costs to the supply function.

3. Over Time, REACT's Proposal Will Harm Those Residential And Small Commercial Customers That Continue To Choose To Take Supply From ComEd

REACT's proposal improperly seeks to shift costs away from those customers that elect to take supply from an alternative supplier to those customers that are eligible and choose to stay with ComEd supply under Rate BES (i.e., residential and small commercial customers). In its brief, REACT fails to acknowledge that if its proposal is accepted, those residential and small commercial customers that choose to stay with ComEd will bear an ever-increasing burden, although REACT witness Merola admitted this result during cross-examination. Merola, Tr. 1907:16 - 1908:4. As the Commission is aware, ComEd would be required to recover the \$64.9 million in these Customer Care costs through its supply rate, from an ever-decreasing number of residential and small commercial customers as switching occurs. At a minimum, additional switching will occur within the 100-400 kW nonresidential class to which service has been declared competitive, the grandfathering of which expires in May 2010. These customers will no longer be able to obtain fixed price supply from ComEd. This, of course, will lead to the remaining customers electing to take supply from ComEd bearing a larger portion of the \$64.9 million. Such a result is unreasonable given that the costs REACT seeks to reallocate are, in fact, incurred, regardless of whether a customer switches to an alternative energy supplier.

Of course, REACT's proposal could ultimately lead to ComEd being unable to recover these costs in any fashion. If all, or almost all, residential and small commercial customers take supply from an alternative supplier, the remaining customers will bear a crushing burden. Again, this result is unreasonable given that REACT has failed to show that ComEd will avoid any of these Customer Care costs should all customer switch to alternative energy suppliers.

4. The Commission Should Not Be Swayed By REACT's Claimed Concerns And Accusations Involving Residential Retail Competition

REACT also urges the Commission to adopt its proposed re-allocation proposal because of its claimed concerns with regard to harming the ongoing development of residential retail competition. REACT Init. Br. at 50-51. This claim is nothing more than an attempt to hide the real reason behind REACT's proposal: it is a blatant attempt to create "margin" or "headroom" by artificially increasing charges under Rate BES and Rider PE to induce customer switching. Crumrine Sur., ComEd Ex. 43.0 Corr., 35:755-57. By shifting costs from ComEd's delivery rates to its supply rates (under Rate BES and Rider PE), ComEd's supply rates will be artificially inflated, thereby providing an incorrect price signal to customers. REACT also goes on to claim that ComEd has an "incentive" to inhibit the development of retail competition, and concocts a scenario that includes Exelon Generation ("Ex Gen") and ComEd President Barry Mitchell. REACT Init. Br. at 72-73. REACT's scenario is pure fantasy. Indeed, if this truly is the competitive issue that REACT claims, the Commission should ask itself: why aren't the other alternative retail suppliers supporting REACT's proposal?⁵⁴ The reason is clear: REACT's

⁵⁴ Neither Constellation New Energy nor the Retail Energy Supply Association supports REACT's proposed re-allocation in their Initial Briefs.

proposed re-allocation of Customer Care costs has little, if anything, to do with the development of retail competition for residential and small commercial customers.

REACT's claims concerning the development of residential retail competition are belied by the facts. *See* Section IX.G, *infra*. Those facts will not be repeated here.

Meanwhile, REACT's rhetoric about ComEd's "incentive" to hinder the development of residential retail competition is likewise contrary to the facts. First, REACT claims that if ComEd "loses" residential or small commercial bundled customers, ExGen's profitability would "presumably" be negatively impacted, particularly when the wholesale price of electricity was dropping at the time this case was filed. REACT Init. Br. at 72-73. From this, REACT further presumes that ComEd would seek to retain bundled customers. *Id.* at 73. Of course, this fiction ignores reality. The record reflects that current and forward prices in April 2008 were well above ExGen's Supplier Forward Contract.⁵⁵ As such, it is apparent that ExGen, even if it were consulted on the subject, would likely welcome the opportunity to reduce sales to ComEd (should bundled customers leave the system) in order to be able to sell more power into today's higher market price. Crumrine Sur., ComEd Ex. 43.0 Corr., 39:846-48. Furthermore, REACT's position ignores the fact that ComEd makes no profit on the sale of the commodity, yet remains at risk to supply and recover its costs from bundled customers. Indeed, ComEd has precisely the opposite incentive from that resulting from REACT's concocted scenario: ComEd has the incentive to have fewer bundled customers in order to reduce its risks.

Unfortunately, REACT resorts to creating a disparaging and false hypothetical in its effort to divert the Commission's attention from the real reason it proposes this reallocation of

⁵⁵ Compare REACT Cross Ex. 17 at page 8 (showing the Ex Gen 2009 contract price at \$49.04 per MWH) with the April 2, 2008 price of \$72.00 per MWH, and a forward April 3, 2008 price of \$63.95 per MWH. Lazare, Tr. 1623:20 – 1625:3.

delivery costs to supply: to improperly inflate ComEd's bundled supply prices for its own gain. The Commission should reject this proposal, and the fiction upon which it is based.

5. Conforming Changes

In the event the Commission, notwithstanding the foregoing, concludes that REACT's re-allocation proposal should be adopted, the Commission's Order in this proceeding should provide for certain conforming changes. First, the Commission should make clear that, notwithstanding any language to the contrary in prior Orders or in current tariffs, ComEd can make the appropriate filings to recover these costs immediately through Rider PE. Second, the Commission's Order also should include a finding that the Customer Care costs being re-allocated are just and reasonable. No party to this proceeding has claimed otherwise, or claimed that such costs are unrecoverable. See, Merola, Tr. 1908:5-16. Accordingly, consistent with Section 16.111.5(l), the Commission should find that these costs are "just and reasonable costs that the utility incurs in arranging and providing for the supply of electric power and energy." 220 ILCS 5/16-111.5(l). Finally, the Commission's Order should direct that ComEd remove the costs to be reallocated to supply from the appropriate delivery service classes in accordance with REACT's Ex. 7.1.⁵⁶ These provisions are necessary in order to ensure proper recovery by ComEd of its just and reasonable costs in a timely fashion.

⁵⁶ The costs that REACT would shift to the supply function have previously been assigned to the delivery customer classes as shown on REACT Ex. 7.1. Accordingly, they should be removed from delivery service classes in the same manner in order to assure that the appropriate classes that will bear the burden of these costs through increased supply charges obtain compensating reductions in delivery service charges.

IX. RATE DESIGN

A. Overview

ComEd's revised rate design proposal is cost-based and results in rates that are just and reasonable for all of its customers. Crumrine Reb., ComEd Ex. 30.0, 43:962 - 44:983. ComEd seeks to base its distribution rates on traditional cost-causation principles to ensure that all customers are paying their fair share for distribution service, or are at least moving in that direction. *Id.*, 44:982-83, 45:1004-05. In contrast, the opposing parties' rate design proposals are designed to protect or exacerbate existing rate subsidies to the benefit of their constituents, or to create new subsidies, all of which must be borne by other customers. Crumrine Sur., ComEd Ex. 43.0 Corr., 31:668 - 32:691. As a result, the parties attacks on ComEd's proposed rate design run from one extreme to another – often having nothing to do with the Commission's rate-setting authority – including calls for the Commission to protect the environment and cries that ComEd's larger customers have done nothing to deserve the proposed rate increase.⁵⁷ *See* CTA Init. Br. at 28-39; METRA Init. Br. at 26; REACT Init. Br. at 60-73. The Commission should accept ComEd's modified, proposed interclass allocation and rate design and reject the modifications proposed by various parties.

B. Uncontested Issues

REACT identifies three allegedly uncontested issues relating to rate design and directs the Commission to arguments made elsewhere in its Initial Brief. REACT Init. Br. at 62. In response, ComEd incorporates its arguments to the designated section of REACT's brief.

⁵⁷ In attacking ComEd's rate design, REACT goes so far as to request that the Commission address supply-related cost allocation. REACT Init. Br. at 61. However, supply related costs are simply not at issue in this proceeding. The Commission has already addressed ComEd's supply-related costs through Rider PE, which was approved in Docket Nos. 07-0528/07-0531.

**1. Identifying Cross-Subsidies
Requires an Accurate Cost Study**

ComEd incorporates herein the discussion of this issue from Section VIII B.2 above.

2. Prudent Rate Design Should Avoid Rate Shock

ComEd incorporates herein the discussion of this issue from Section VIII D. above.

**3. Prudent Rate Design Should Consider
Wider Economic Effects of Increase**

ComEd incorporates herein the discussion of this issue from Section VIII D. above.

C. Rate Design Issues

1. Residential Customers

The City argues that the Commission should set the monthly customer charge at \$3.00 per customer. City Init. Br. at 24. As more fully discussed in ComEd’s Initial Brief, the Commission should reject the City’s proposal to reduce the monthly customer charge because: (1) the City’s proposed reduction in the monthly customer charge is not cost-based (Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 25:420-23; Rubin Reb., AG Ex. 6.0, 19:446 - 20:451); (2) the foundation for this proposal is premised on the misconception that low-income customers are low electricity use customers (Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 24:403 - 25:409); and (3) assistance to low-income customers should not be accomplished through arbitrarily set rates for electricity service (*id.* at 25:421-23). ComEd Init. Br. at 105.

2. Non-Residential Customers

a. Space-Heating Customers

BOMA continues its plea to the Commission to “resolve the Rider 25 issue.” BOMA Init. Br. at 23. This issue has been resolved. The Commission has addressed BOMA’s arguments in Docket No. 05-0597 and Docket No. 07-0166. As evidenced by its very

elimination, former Rider 25 was a vestige of the past and did not reflect ComEd's transition to a delivery company. Crumrine Reb., ComEd Ex. 30.0, 52:1174 - 53:1193.

BOMA's request to establish a separate, subsidized class or distribution charge for nonresidential electric space heat customers should be rejected because no evidence shows that the costs of providing distribution service are somehow different for nonresidential electric space heat customers. ComEd Init. Br. at 106-07. BOMA concedes in its Initial Brief that it has no such evidence. BOMA Init. Br. at 19-21. Instead, BOMA makes the tenuous argument that the cost of service for residential customers "varies in relation to whether the customer heats with electricity or natural gas" and, as a result, there "exists at a minimum a likely inference that the same would hold true for non-residential customers." *Id.* at 21.

BOMA devotes a significant portion of its Initial Brief to its argument that BOMA members have historically "suffered rate shock on a bundled and unbundled basis." BOMA Init. Br. at 10-18. However, ComEd demonstrated that all nonresidential customers with demands between 400 kW and 3,000 kW experienced increases between 1999 and 2007 that were higher than the overall nominal 38% increase in the revenue requirement over those eight years. Alongi/Jones Reb., ComEd Ex. 32.0 Corr., 20:346 - 22:380, Table R7. ComEd also demonstrated that customers in these classes have had to shoulder the burden of the subsidies instituted for the benefit of customers in the high voltage and larger demand classes, as well as customers in the railroad class, thereby necessarily increasing their rates. *Id.* For example, ComEd's evidence showed that between 1999 and 2007 the change for the Over 10,000 kW class was an increase of just 28.8%, the change for the High Voltage Over 10,000 kW subclass was a decrease of 39.7%, and the change for the Railroad Delivery Class was a decrease of 29.5%. Alongi/Jones Sur., ComEd Ex. 45.0, 13:255-14:264; *see* Alongi/Jones Reb., ComEd Ex. 32.0

Corr., 22:370-80, Table R7. The increases for the remaining nonresidential classes exceeded the overall increase of 38%, principally to offset these changes. Alongi/Jones Sur., ComEd Ex. 45.0, 13:255-14:264.

b. Railroad Customers

i. Operational Issues

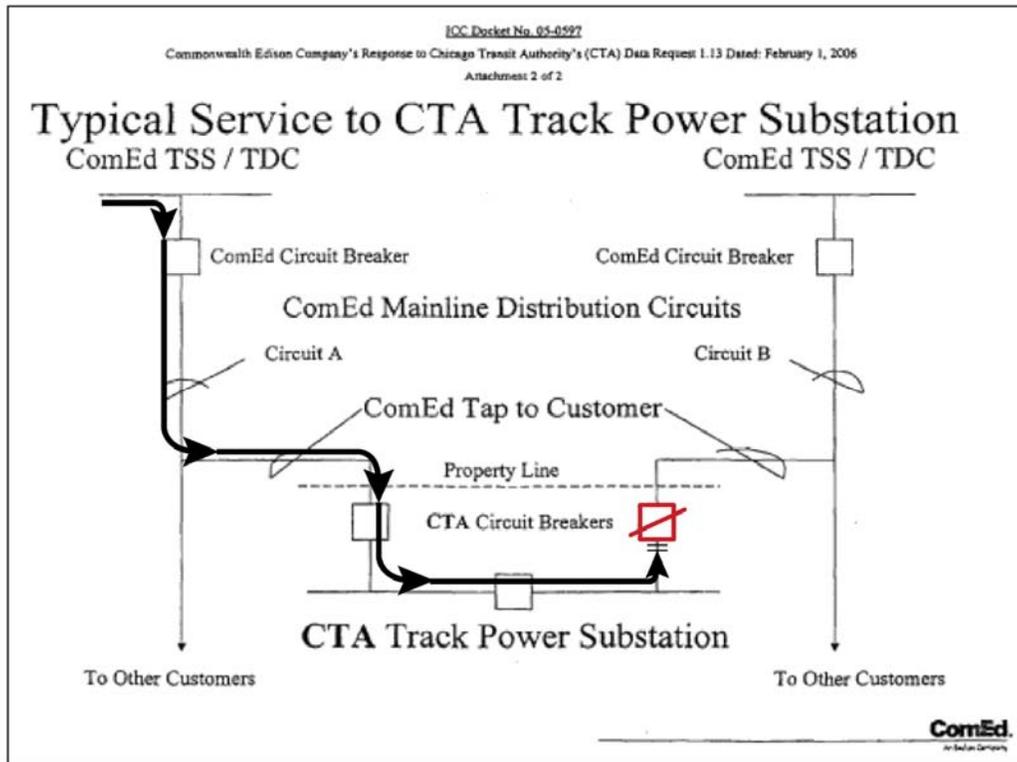
The CTA argues that the particular and more expensive supply arrangement it has demanded at its traction power substations – whereby its own service reliability is enhanced by receiving power through two distribution circuits joined by a bus and breaker, rather than the usual single circuit – entitles it to special rate concessions. As ComEd anticipated in its Initial Brief (at p. 107), this is the very same argument that the CTA made in ComEd’s last rate case. The Commission studied the CTA’s claims, found them to be without merit, and rejected them. *Commonwealth Edison Co.*, Docket No. 05-0597, Order at 254-55. The facts have not changed, and the CTA has given no valid reason why the decision should change.

The essence of the CTA’s argument is its insistence that it “provides reliability to ComEd’s system by the fact that the CTA traction power substations at each location connect to at least two separate ComEd circuits allowing through-flow to serve other ComEd customers.” CTA Init. Br. at 31. That statement, however, is incorrect. The reason the CTA is served by two distribution lines joined by a breaker is for the reliability of the railroad and it was designed that way at their request, not for ComEd’s reliability. Zika, Tr. 1418:12 - 1419:10; *accord* Szerla, Tr. 1438:1 - 1439:2 (as to METRA). The double feed and breaker allows the CTA, in the event of a fault on one of the two lines, to isolate itself from the fault by opening its breaker,⁵⁸

⁵⁸ In electrical engineering a “closed” breaker means that it is set to allow electricity to flow across the breaker into the connecting lines. An “open” breaker stops the flow of electricity.

and to continue to receive power on the other, unaffected line. Donnelly Reb., ComEd Ex. 21.0 Corr., 109:2226-32. This closed loop feeder configuration is not an optimal way, from ComEd's perspective, to serve an individual customer, and ComEd has not used that configuration to serve a new customer for many years. Donnelly Sur., ComEd Ex. 36.0, 25:502-510.

Under normal system conditions, the CTA's breaker is closed, as shown in the diagram on page 32 of the CTA's Initial Brief, and both of the lines feeding the CTA are energized. As the Commission found in the last rate case, under the laws of physics it may be possible that electrons at times flow across the CTA bus, bound for other ComEd customers. Docket No. 05-0597, Order at 255. The CTA goes to considerable length to demonstrate that such flows do take place. CTA Init. Br. at 33-35. That electrical fact, however, begins the analysis; it does not end it. The record shows that those flows have nothing to do with increased reliability of service to other customers. Donnelly Sur., ComEd Ex. 36.0, 20:412-14, 21:427-30. The flow of electrons under normal system conditions can hardly be construed as ComEd "using" the CTA's facilities to enhance system reliability. Consistent with responsible utility system design, no ComEd customers are actually dependent on CTA-owned equipment for their power. Luedtke, Tr. 2235:5-10; Donnelly Sur., ComEd Ex. 36.0, 23:462-64. In other words, the CTA could open its breaker, prevent the flow of electrons across its equipment, and ComEd's other customers would continue to receive electricity.



Moreover, in the event that a fault does occur on one of the two ComEd lines, the CTA will open its breaker, thereby preventing power from flowing to ComEd's other customers. This is illustrated in *Donnelly Reb.*, ComEd Ex. 21.0 Corr., 108:2213-20, and reproduced above. This demonstrates that the CTA equipment is designed for the benefit of the CTA, as one would expect, and not for ComEd's other customers. Nothing in the CTA configuration would justify special pricing at the expense of other customers.

ComEd notes that METRA's testimony raised a number of the same claims that the CTA raises, but METRA did not address them specifically in its Initial Brief. The facts are essentially identical, however, and METRA also has no entitlement to a special rate.

ii. Railroads' Request for Special Treatment

METRA and the CTA take the position that, in setting rates for the railroads, the Commission must consider public policy matters, such as the efficient use of energy and

avoidance of adverse impact on mass transit, citing the Commission’s order in the last rate case. METRA Init. Br. at 4, 26; CTA Init. Br. at 36. While ComEd recognizes that the Commission made certain statements in that Order regarding the impact of rate increases on the railroads, it did not order ComEd to reflect such considerations in future rate cases. However, ComEd submits that these “public policy” statements did not alter the Commission’s authority in this rate case proceeding, which is to (a) establish rates that are just and reasonable and (b) ensure that the rates do not unduly discriminate between customers and customer classes. *See* 220 ILCS 5/9-101, 5/9-241.

The Commission should approve ComEd’s proposed rate design, because it sets rates in a manner that does not unduly discriminate in favor of, or against, any groups or types of customers. Moreover, under ComEd’s proposed rate design, neither ComEd nor the Commission will be put in the untenable position of picking worthy causes and requiring that other customers subsidize use of the electric distribution system. *Crumrine Reb., ComEd Ex. 30.0, 51:1148-50.* Finally, the railroads’ argument that ComEd’s “dramatic” proposed increase for their class “blatantly ignores the Commission’s public policy findings” (CTA Init. Br. at 36; METRA Init. Br. at 4-6) conveniently forgets that their proposed percentage increase in rates is due to the specific interclass subsidies created, at the Railroads’ request, in ComEd’s last rate case.⁵⁹ *Crumrine Dir., ComEd Ex. 11.0 Corr., 6:128-29.*

⁵⁹ Ironically, the CTA and METRA are unconcerned about the “dramatic” impact that their various ECOSS proposals would have on residential rates – their support of the MDS approach and primary/secondary split would result in residential rates increasing by 54%, instead of the 24% increase under ComEd’s proposal. See Section VIII.A *infra*.

iii. The CTA's Contract with ComEd

The CTA argues that the Commission should consider the CTA's contract with ComEd in setting rates for the Railroad Delivery Class. CTA Init. Br. at 29-31. The Commission should not take the contract into account because it is beyond the scope of the Commission's authority in this rate case proceeding. *See* 220 ILCS 5/9-101, 5/9-241. Even if the Commission were to recognize the existence of the CTA contract in some fashion in setting rates, the Commission also would have to consider the numerous modifications to the contract over the years, such as through ComEd's filing after the last rate case of Rate BES-RR, revised sheets in Rate RDS, Rider NS, Rider ML, and ComEd's General Terms and Conditions, as well as that the CTA no longer takes electricity supply from ComEd. *Alongi/Jones Reb.*, ComEd Ex. 32.0 Corr., 44:722-31. Rather, the Commission should continue to find that ComEd's contracts for electric service with its two railroad customers are subject to modification pursuant to Commission Orders. Further, the Commission also should find that ComEd's tariffs filed in compliance with Commission Orders or legislation serve to amend the railroad contracts without explicitly changing the language of the railroad contracts. *Alongi/Jones Sur.*, ComEd Ex. 45.0, 2:37-42.

c. Primary and Secondary Billing Proposal

DOE and IIEC request that the Commission order that ComEd distinguish "between standard voltage load and high voltage load for customers in the High Voltage Delivery Service class in the billing of these customers." IIEC Init. Br. at 85, fn. 20; DOE Init. Br. at 14-15. Whereas DOE proposes that ComEd charge two separate distribution facilities charges to customers in the High Voltage Delivery Class that are served at multiple points with some lines entering the premises at voltages below 69,000 volts, IIEC proposes that ComEd implement a surcharge for the load of high voltage customers served at lower voltages. DOE Init. Br. at 14-

15; Swan Reb., DOE Ex. 2.0, 20:461-63, 473-76; IIEC Init. Br. at 86-87; Stephens Reb., IIEC Ex. 5.0, 14:256 – 16:292. ComEd’s response to data request DOE 7.09, attached to Dr. Swan’s rebuttal testimony as DOE Ex. 2.3, details complexities and difficulties in implementing two separate distribution facilities charges. In addition, this response explains how ComEd bills for Rider ZSS and why it would not be the same here. Yet, both DOE and IIEC ignore this evidence and suggest that implementation “should not be a problem.” DOE Init. Br. at 15; IIEC Init. Br. at 86. In addition, DOE and IIEC both attempt to suggest that any difficulties should disappear because only a few customers are involved, but ignore that the complexity of system changes are independent of the number of customers affected. DOE Init. Br. at 15; IIEC Init. Br. at 86. Both proposals should be rejected, because implementation would be very difficult and complex and is simply not warranted for the small portion of the billing demand that would be impacted by either proposal. Alongi/Jones Sur., ComEd Ex. 45.0, 14:265 - 15:296.

D. Existing Riders

1. Rider ACT

Staff and DOE support ComEd’s revised proposal for Rider ACT (Allowance for Customer-Owned Transformers). Staff Init. Br. at 103; DOE Init. Br. at 15. The only party objecting to ComEd’s revised proposal is REACT, which argues that Rider ACT should be retained in its current form because ComEd has not provided evidence to show that the rider is inconvenient. REACT Init. Br. at 62-64. ComEd has demonstrated its sound reasoning for revising Rider ACT. ComEd Init. Br. at 110-12; Alongi/Jones Dir., ComEd Ex. 12.0 Corr., 21:367 - 22:392; Alongi/Jones Reb., ComEd Ex. 32.0, 41:669-74. Moreover, it is noteworthy that by insisting Rider ACT must be retained in its current form, REACT is rejecting an option for customers in ComEd’s proposed revisions to Rider ACT. ComEd is willing to make a one

time payment to customers that voluntarily elect to terminate service under Rider ACT. Alongi/Jones Sur., ComEd Ex. 45.0, 20:406 - 21:409. Under REACT's recommendation, customers would not be allowed to take advantage of that option. *Id.* at 21:409-10. Further, in the past 10 years only 35 customers have elected service under Rider ACT or its predecessor. *Id.* at 21:411-12. Closing the rider to new customers is not onerous because virtually no new customers elect to take service under the rider and those that did generally did so for operational reasons unique to their business. *Id.* at 21:412-14. In light of the agreement among the majority of the parties on ComEd's revised proposal for Rider ACT, the Commission should find ComEd's revised proposal on Rider ACT to be just and reasonable.

2. **Rider AC7**

ComEd's Initial Brief and Mr. Crumrine's testimony addressed "the ratemaking adjustment to ComEd's delivery service revenue requirement that is needed to reflect the revenues streaming from Rider AC7 – Residential Air Conditioner Load Cycling Program 2007 ("Rider AC7") at current compensation levels." ComEd Init. Br. at 112-13; Crumrine Dir., ComEd Ex. 11.0 Corr., 1:15-18. In particular, ComEd proposes a ratemaking adjustment to reduce the Illinois-jurisdictional revenue requirement by just under \$500,000 in order to reflect the difference between the market value of the capacity in the PJM market and the compensation payments made to residential customers enrolled in Rider AC7 (for the ability to cycle or interrupt the compressor on air conditioning units). Crumrine Dir., ComEd Ex. 11.0 Corr., 22:447-49.

While CUB raised an issue on this topic in direct testimony, it did not respond to ComEd's rebuttal testimony, nor did it raise the issue in its Initial Brief. Accordingly, the Commission should approve ComEd's ratemaking adjustment to ComEd's delivery service

revenue service requirement that is needed to reflect the revenues streaming from Rider AC7 as proposed.

3. Rider ML [and Rider SBO7] (Uncontested)

Staff does not oppose ComEd's proposed changes to Rider ML. Staff Init. Br. at 103-04. No other party addressed Rider ML in Initial Briefs. Further, no party addressed ComEd's proposed changes to Rider SBO7 in Initial Briefs. Accordingly, the Commission should approve Rider ML as proposed. Rider SBO7 should be approved with the SBO credit reflecting the revenue requirement approved by the Commission.

4. Rider MSPS7 [and Rate BES-H] (Uncontested)

Staff does not oppose ComEd's proposed changes to Rate MSPS7. Staff Init. Br. at 104. No other party addressed Rate MSPS7 in Initial Briefs. Further, no party addressed ComEd's proposed changes to Rate BES-H in their Initial Briefs. Accordingly, the Commission should approve Rider MSPS7 and Rate BES-H as proposed.

E. Distribution Loss Factors

As discussed in ComEd's Initial Brief, ComEd's distribution losses study employed a sound methodology and produced valid results. ComEd Init. Br. at 115-16. ComEd has applied new sources of information, like its geographic information system, that allow more complete and accurate tracking of losses to customers. Donnelly Reb., ComEd Ex. 21.0 Corr., 115:2342 - 116:2354. The improvements in the data now available show that the distribution loss factors of ComEd's largest high voltage customers are higher than had been thought in past cases. However, even with the best data now available, their distribution loss factors are still the lowest of any class. The REACT's members in that class do not present a single valid criticism of ComEd's study, but nonetheless contest that their loss factor is increasing. REACT Init. Br. at 9-

10, 64-67. Their parochial wish for lower loss factors is not a good reason to use a different, less accurate, number.

REACT argues that ComEd has failed to explain how it arrived at the distribution loss factors it did. That is simply not the case. ComEd included the loss factors in its initial filing. When REACT raised its issues in direct testimony, ComEd offered additional explanation, along with the actual study, into the record. Donnelly Reb., ComEd Ex. 21.0 and ComEd Ex. 21.1. The record is in no way deficient on this subject.

REACT also suggests that ComEd not be permitted to treat over-10 MW high voltage customers as a class for purposes of distribution loss factors. REACT Init. Br. at 67. That proposal lacks merit for a number of reasons. First, it would be contrary to ratemaking practice in Illinois. Distribution loss factors have never been calculated and applied individually.

Second, individual loss determinations would be difficult and expensive to conduct and would have to be conducted repeatedly to remain “individual.” Every time a customer’s use or location – or the configuration of the ComEd system in the area – changed, as new study would be required.

Third, the results would necessarily be arbitrary. One customer on the system could have very different loss factors from an otherwise identical customer located in another part of the system. Moreover, the line losses associated with a particular customer will change over time, depending on how ComEd is required to adapt its system to new load and new customers. These changes would affect customers without any change in the customer’s own behavior or use.

Finally, REACT’s proposal calls for a high-stakes zero-sum game. REACT does not say it, but the customer-by-customer study would have winners and losers, with the overall losses for the class not changing. Some customers would find themselves with larger distribution loss

factors, and there is probably no way the customer could know, based on information it has today, that it would be one of the losers. In this case, treating these customers as a class – as has been done in all past cases – based on shared attributes is more appropriate than treating them individually.

F. Recovery of Supply-Related Costs

See Section VIII F.

G. Competitive Retail Market Development Issues

REACT’s claims about the development of a competitive retail market are irrelevant to this case and should be dismissed for that reason alone. REACT Init. Br. at 69-73. They are also wholly incorrect.

Contrary to REACT’s assertions about ComEd’s motives, ComEd strongly supports a competitive market for residential customers and has been working to advance efficient competition since the passage of the Electric Service Customer Choice and Rate Relief Law of 1997, 220 ILCS 5/16-101 *et seq.* *See, e.g.,* Mitchell, Tr. 128:2-4; Crumrine, Tr. 1410. REACT fails to recognize the historical factors that have dominated the degree to which residential customers could switch to RES service. For example, at the time ComEd made residential switching available for the first time, “residential customers were enjoying a 20 percent rate reduction and a rate freeze that ultimately ran all the way through 2006.” Crumrine, Tr. 1409:10 – 1410:3. These factors were “a primary hindrance to any residential switching.” *Id.* at 1410. Further, there are factors currently outside the control of ComEd that affect the degree of residential customer switching. *Id.* One such factor is the business decision a RES must make related to expending the costs to acquire an individual residential customer. Such customers have a relatively small load and, therefore, will result in a relatively minor profit. *Id.*

REACT also accuses ComEd of intentionally attempting to block customer switching by its residential customers and its smallest commercial customers through allegedly questionable switching projections and improper supply cost allocation. *Id.* at 1410:4-19 ComEd has addressed the cost allocation point in Section VIII., *supra*. With respect to the variations in ComEd's switching projections, these figures have always represented only projections based on market prices and do not reflect ComEd's preferred outcome

H. Other Issues

None.

X. REVENUES

A. Miscellaneous Revenues (Uncontested)

This issue remains uncontested.

B. Weather Normalization

See ComEd Init. Br. at 120-121. No other party addressed this subject.

XI. OTHER ISSUES

A. Annual Reporting on Changes in Accounting Policy (Uncontested)

This issue remains uncontested.

B. Reporting on Affiliate Interest Transactions (Uncontested)

This issue remains uncontested.

C. Reporting of Pass-Through Transactions (Uncontested)

This issue remains uncontested.

D. Future Depreciation Studies (Uncontested)

As stated in both ComEd's and Staff's Initial Briefs, the issue of Future Depreciation Studies is not contested. ComEd Br. at 122; Staff Br. at 108. Staff included in its discussion of

Future Depreciation Studies, however, the following notation on a different issue: “Staff and ComEd plan on meeting in the future to discuss the use of ComEd’s internal auditors to conduct audits of additions to plant in service, with the scope and nature of the internal audits to be determined.” McDonald, Tr. 1768:15 - 1769:12. Staff Br. at 109. ComEd has indicated it will work with Staff on this matter, as evidenced by ComEd witness Mr. Robert McDonald’s testimony.

Q. Okay. And would ComEd be willing to work with the Commission Staff to prepare an audit scope that can be used by the Company’s internal auditors to conduct annual internal audits of the Company’s additions to plant and service?

A. We are certainly willing to work with Staff and talk about the nature and scope of such an audit, what we would be looking for, what the porosity of it would have to be, and certainly willing to work with Staff on what that might look like.

McDonald, Tr. 1769:2-12.

XII. CONCLUSION

For the reasons stated herein and in ComEd’s Initial Brief, the Commission should approve new rates for ComEd as described in ComEd’s Initial Brief. Nothing in the Initial Briefs of the other parties change that result.

Dated: June 16, 2008

Respectfully submitted,

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I, E. Glenn Rippie, do hereby certify that a copy of the foregoing COMMONWEALTH EDISON COMPANY'S REPLY BRIEF was served upon all parties on the attached Service List by the method so indicated this 16th day of June, 2008.



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