

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Commonwealth Edison Company	:	
	:	
Proposed general increase in electric rates (tariffs filed October 17, 2007)	:	Docket No. 07-0566
	:	
	:	

**REPLY BRIEF OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission’s (“Commission”), respectfully submits its Reply Brief in the above-captioned matter regarding the filing by Commonwealth Edison Company (“ComEd” or the “Company”) for a proposed general increases in electric rates.

I. INTRODUCTION / STATEMENT OF THE CASE

The Initial Brief of the Staff of the Illinois Commerce Commission (“Staff’s Initial Brief” or “Staff IB”) was filed on May 29, 2008. The Initial Brief of AARP (“AARP’s Initial Brief” or “AARP IB”), the Initial Brief of The People of the State of Illinois (“AG’s Initial Brief” or “AG IB”), the Initial Brief of The Building Owners and Managers Association of Chicago (“BOMA’s Initial Brief” or “BOMA IB”), the Chicago Transit Authority’s Initial Hearings Brief (“CTA’s Initial Brief” or “CTA IB”), the Initial Brief of the City of Chicago (“City’s Initial Brief” or “City IB”), the Initial Brief of the Citizens Utility Board (“CUB’s Initial Brief” or “CUB IB”), the Initial Brief of Commonwealth Edison Company (“ComEd’s

Initial Brief” or “ComEd IB”), the Post-Hearing Brief of the Commercial Group (“CG’s Initial Brief” or “CG IB”), the Initial Brief of Constellation NewEnergy, Inc. (“CNE’s Initial Brief” or “CNE IB”), the Initial Brief of the Illinois Industrial Energy Consumers (“IIEC’s Initial Brier” or “IIEC IB”), the Initial Brief of the Kroger Co. (“Kroger’s Initial Brief” or “Kroger IB”), Metra’s Initial Post-Hearing Brief (“Metra’s Initial Brief” or “Metra IB”), the Initial Brief Of Nucor Steel Kankakee, Inc. (“Nucor’s Initial Brief” or “Nucor IB”), the Initial Brief of the Coalition to Request Equitable Allocation of Costs Together (“REACT’s Initial Brief” or “REACT IB”), the Initial Brief of the Retail Energy Supply Association (“RESA’s Initial Brief” or “RESA IB”), and the Initial Brief of the United States Department of Energy (“DOE’s Initial Brief” or “DOE IB”) were also filed or served on May 29, 2008.

Some of the issues raised in the parties’ initial briefs were addressed in Staff’s Initial Brief and, in the interest of avoiding unnecessary duplication, Staff has not repeated every argument or response previously made in Staff’s Initial Brief. Thus, the omission of a response to an argument that Staff previously addressed simply means that Staff stands on the position taken in Staff’s Initial Brief, and should not be construed or interpreted as a waiver or retraction of Staff’s previously stated position.

ComEd seeks to justify its proposed \$314.5 million rate increase as “a significant and essential step towards restoring ComEd’s financial health”. ComEd IB, p. 1. The Company goes on to state that “ComEd is one of only two distribution utilities in the country with below-investment grade ratings, AmerenIP being the other.” ComEd IB, p. 2. The implication of this argument is that the Commission is therefore required to do whatever is necessary to cure the Company’s financial ills. The problem with this

argument is that ratepayers had no control over the decisions that led to the Company's financial predicament. It was ComEd that decided to divest generation and transform itself into a transmission and distribution utility. Now, as bundled rates spiral upwards, both the Company and ratepayers are enduring the consequences of that decision. It is not the Commission's job to rescue the Company from those consequences by increasing the burden faced by ratepayers. Instead, the Commission should only allow ComEd recovery for those costs it has demonstrated are just and reasonable.

IV. RATE BASE

B. Uncontested Issues

1. Plant

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

ComEd and Staff reached an agreement on the resolution of certain issues between them as reflected in the Stipulation Concerning Incorporation of Certain Adjustments from the Original Cost Audit and Resolution of Certain Revenue Requirement and Other Issues (the "Stipulation"). Staff-ComEd Joint Ex. 1. The AG argues that it would be unlawful for the Commission to adopt the proposed resolution of issues set forth in the Stipulation reached between Staff and ComEd. AG IB, pp. 3-5. As explained below, Staff disagrees because the proposals reflected in the Stipulation are fully supported by the evidence in this proceeding and should be adopted on the merits. Further, Staff submits that the Stipulation has been misinterpreted or mischaracterized with respect to those matters for which it merely calls for Staff to withdraw certain of its proposals.

The AG's arguments raise questions regarding the status and treatment of settlements, so we begin with a discussion of the Commission's authority to consider settlement proposals. The Illinois Administrative Procedures Act provides that "[u]nless precluded by law, disposition may be made of any contested case by stipulation, agreed settlement, consent order, or default." 5 ILCS 100/10-25. In Business and Professional People for the Public Interest v. Illinois Commerce Comm'n, 136 Ill.2d 192 (1989) ("BPI I") the Illinois Supreme Court held that "[i]n order for the Commission to dispose of a case by settlement, however, all of the parties and intervenors must agree to the settlement." *Id.* at 209 (citations omitted).

Consistent with federal law, the Supreme Court in BPI I also recognized that proposals which do not have unanimous support among the parties may nevertheless be adopted by the Commission on the merits:

Mobil provides that if a settlement proposal has unanimous support, an agency could adopt it as a settlement agreement. *Mobil* also holds, however, that if such a proposal lacks unanimous support, the agency may adopt it as a resolution on the merits. In other words, if the agency makes an independent finding, supported by substantial evidence in the record as a whole, that the proposal would establish just and reasonable rates, the agency may adopt a settlement proposal which fails to garner unanimous support.

Our decision mirrors this holding. ...

Id. at 216-217.

Staff's and ComEd's acknowledgement of this legal standard is evidenced by Section II, par. 4 of the Stipulation which states "ComEd and Staff have each concluded that the resolution of issue addressed in this Stipulation is fully supported by facts and evidence submitted, and is just and reasonable under the circumstances." Staff-ComEd Joint Ex. 1, p. 3. The AG and CUB each acknowledge this legal standard, but

principally argue that the evidence in the record does not support the adjustments agreed to by ComEd and Staff in the Stipulation. AG IB, pp. 3-5; CUB IB, pp. 3, 5. To the contrary, all of the adjustments addressed in the Stipulation are supported by evidence in the record and should be adopted on the merits.

First, with respect to the \$171.755 million downward adjustment to rate base (less accumulated depreciation and accumulated deferred income taxes) related to third quarter 2008 pro forma additions (Staff-ComEd Joint Ex. 1, p. 3 (Section II, par. 5, 1st bullet)), Staff submitted the corrected rebuttal testimony of Staff witness Griffin who testified that the adjustment was reasonable for the following reasons: (1) he considered additional ComEd responses to data requests which indicated that capacity expansion projects which composed some of the pro forma additions are summer critical and must be closed by June 1, 2008; the projects are required to be closed by specific times by a government entity; the capacity expansion projects are considered short term CWIP that do not accrue AFUDC and the projects have contracts with completion dates and costs; (2) ComEd witness Donnelly testified that \$114.1 million of distribution projects had already been placed into service as of February 29, 2008 and many of the remaining projects are summer critical (i.e., projects to be constructed and in service by June 1 prior to the hottest part of the summer when ComEd's system usually hits its peak (ComEd Ex. 21.0 (Corrected), 24:513-516); and (3) ComEd's agreement that the extent to which actual pro forma additions actually placed into service during the first two quarters of 2008 (on a combined basis) are less than the projected pro forma additions for the first two quarters of 2008 (\$540.40 million) then plant in service would be

reduced by an additional amount equal to the difference between actual and projected. See Staff IB, pp. 11-12; Staff Ex. 15.0 Corrected, 6:117-7:143.

Second, with respect to Staff withdrawing its proposal to adjust plant in service and accumulated depreciation balances to the actual amounts known at December 31, 2007 (ICC Staff Exhibit 2.0 Corrected, 8:151-162 and Schedule 2.2; Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 2nd bullet)), Staff witness Griffin testified that because ComEd was no longer proposing pro forma additions which resulted in a comprehensive restatement of plant balances, the adjustment was no longer necessary. ICC Staff Exhibit 15.0 Corrected, 8:155-9:171 (See also, Section IV.C.2 below for a further discussion). Staff's withdrawal of its proposed adjustment to accumulated depreciation is also supported by legal considerations. The Commission has recently rejected on multiple occasions proposals to adjust accumulated depreciation for depreciation of test year rate base assets during the pro forma adjustment period. See ComEd IB, pp. 34-35. In rejecting these proposals, the Commission highlighted the fact that it considered such proposals to "take[] one part of the rate base and move[] it one additional year into the future ... [so as to] inappropriately bring the test year into the future for accumulated depreciation." *Commonwealth Edison Co.*, ICC Docket No. 05-0597, (Final Order, July 26, 2006), at 15.

Staff's original adjustment was distinguishable from these prior rulings because Staff viewed ComEd's original pro forma adjustment proposal to constitute a comprehensive restatement of its plant balances. Staff's position is that where a utility's pro forma adjustments constitute a comprehensive restatement of its plant balances, it is appropriate and necessary to update all plant balances – including accumulated

depreciation. As noted above, ComEd's agreement to revise its proposed pro forma adjustments changed the facts such that Staff no longer believed it could or should argue that ComEd was engaging in a comprehensive restatement of its plant balances in a manner that distinguished the instant case from the Commission's recent rulings on this issue. As a result, Staff's position that it is appropriate to make an accumulated depreciation adjustment where the utility engages in pro forma adjustments constituting a comprehensive restatement of its plant balances was essentially moot and neither could nor should be considered in this docket. Thus, for the foregoing reasons, Staff's withdrawal of its proposed adjustment to accumulated depreciation is fully supported by the record.

The AG and ComEd also appear to read more into the Stipulation than in fact exists with respect to the withdrawal of Staff's accumulated depreciation adjustment. See AG IB, pp. 3-5; ComEd IB, p. 33, fn. 22. The Stipulation does contain a paragraph that makes acceptance of each agreed resolution contingent upon acceptance of all agreed resolutions:

ComEd and Staff agree to support the adoption by the Commission of the resolutions of the issues as provided in Sections I and II of this Stipulation. As stated herein, ComEd and Staff agree not to pursue certain conclusions or not object to certain other conclusions. In so agreeing, each is necessarily agreeing to waive its right to pursue alternative conclusions as advocated in testimony each has submitted or otherwise. Such waiver, however, **is expressly limited to acceptance by the Commission of the totality of the agreements set forth herein. If the agreements set forth herein are not accepted in their totality, then ComEd and Staff each reserve their respective rights to continue to advocate other positions.**

Staff-ComEd Joint Ex. 1, p. 4 (Section III, par. 1) (emphasis added). With respect to accumulated depreciation, Staff and ComEd merely agreed that Staff would withdraw its proposed adjustment:

Staff will withdraw its proposed adjustment to plant in service and accumulated depreciation for 2007 as set forth in the Direct Testimony of Mr. Thomas Griffin (Staff Ex. No. 2.0, lines 79-162) ("Griffin Testimony").

Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 2nd bullet). Staff and ComEd did not agree to the rejection of any other party's proposal on accumulated depreciation, or to a specific accumulated depreciation amount. While it may be that the AG's proposed accumulated depreciation adjustment will be rejected by the Commission given the Commission's recent rulings on this issue as discussed above, Staff did not lock the Commission into rejecting the AG's position as a condition of accepting the proposed set of issue resolutions set forth in the Stipulation. To the extent that the AG argues that the Commission must reject and cannot approve the Stipulation's proposed set of issue resolutions because of the AG's position on accumulated depreciation, the AG is in error. The Stipulation does not impact the Commission's ability to decide the accumulated depreciation proposals by other parties on the merits. Similarly, Staff disagrees with the statement in ComEd's Initial Brief "that ComEd's agreement in the Staff/ComEd Stipulation to exclude the capital additions for [3rd] quarter [2008] is conditioned upon, among other things, there being no adjustment at all to the Depreciation Reserve for test year plant." ComEd IB, p. 33, fn. 22. As explained above, the exclusion of third quarter pro forma adjustments is conditioned upon Staff withdrawing its proposed depreciation reserve adjustment, but it is not conditioned upon a rejection of other parties' depreciation reserve adjustments or a particular overall accumulated depreciation amount.

Third, with respect to Mr. Griffin's withdrawal of the accounting adjustments related to: (1) changes in ComEd's property Unit Catalog; (2) capitalization thresholds for software developed or obtained for internal use; (3) inclusion of contract labor in the

base for loading of departmental overheads and (4) stores clearing account (Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 3rd bullet), Staff witness Griffin provided testimony as to why those adjustments were being withdrawn as previously set forth in Staff's Initial Brief (Staff IB, pp. 7-10). In addition, Staff witness Griffin provided rebuttal testimony withdrawing his proposal to allocate common plant for combination substations according to the proportion of distribution facilities and transmission facilities at such substations. Mr. Griffin explained that ratepayers would not be harmed given that his proposal simply involved a shifting of costs between distribution rates and transmission rates. ICC Staff Exhibit 15.0 Corrected, p. 12.

Fourth, with respect to the recovery of costs related to the original cost audit ("OCA"), ComEd agreed to Staff's proposal set forth in Staff's direct testimony (ICC Staff Exhibit 2.0, Schedule 2.1) to reduce those expenses by \$265 thousand to \$516 thousand. Staff-ComEd Joint Ex. 1, p. 6 (Section II, par. 11).

Fifth, with respect to the recovery of rate case expense for the current docket, ComEd agreed to Staff's proposal set forth in its rebuttal testimony (ICC Staff Exhibit 15.0 Corrected, pp. 12-13) that rate case expense be set at \$10,500,000 in total with a three year amortization period resulting in an annual amount of \$3.5 million. Staff-ComEd Joint Ex. 1, p. 6 (Section II, par. 12).

Sixth, with respect to ComEd's voluntary agreement to reduce rate base by an additional \$35.746 million as a result of adjustments proposed in or related to the Original Cost Audit ("OCA") (Staff-ComEd Joint Ex. 1, pp. 1-2 (Section I, par. 4)), the AG apparently suggests that this \$35.746 million reduction to rate base cannot be adopted by the Commission because the OCA Report is not in the record evidence of

this proceeding. AG IB, p. 4. Staff is bewildered as to why the AG would oppose such a rate base **reduction** which clearly benefits ratepayers. Absent the Stipulation any rate base reduction which resulted from the OCA would not have been reflected in this proceeding, given that (i) the Interim Order in Docket No. 05-0597 provided that "... no later than 30 days after such time as the Commission's order in the Audit Approval Docket is final, ComEd shall reflect the changes, if any, required by the Commission on its books and records [and] [n]othing shall preclude recognition of such changes in any **subsequent** case or proceeding before this Commission" (*Commonwealth Edison Co.*, ICC Docket No. 05-0597, (Interim Order, April 5, 2006), at 2-3 (emphasis added)) and (ii) the Audit Approval Docket (Docket No. 08-0312) was initiated on May 13, 2008, which was subsequent to the date the record in this proceeding was marked heard and taken.

In addition, the AG's assertion that no record evidence exists to support this adjustment is wrong. The AG ignores Staff witness Griffin's rebuttal testimony on this issue. Mr. Griffin testified as to the three specific items which are included in the \$35.746 million adjustment and how those components related to the OCA findings of Alliance Consulting Group, the entity retained by the Commission to conduct the OCA. Mr. Griffin's testimony provides sufficient evidentiary basis to support this adjustment, particularly in light of the fact that the adjustment benefits ratepayers and ComEd does not object to the adjustment as part of the Stipulation.

To the extent that the AG is arguing that the approval of the resolutions set forth in the Stipulation would somehow pre-determine the outcome of the Audit Approval

Docket, the AG has again misread or misinterpreted the Stipulation. With respect to the Audit Approval Docket the Stipulation merely provides as follows:

Staff agrees that it will not advocate that any conclusions or recommendations identified in the OCA Report should be adopted or ordered by the Commission in the Audit Docket or that any adjustments identified in the Audit Report should be made except as set forth in this Stipulation. ComEd agrees that it will not object to any Commission decision to initiate a proceeding to consider the results of the OCA or to the intervention of any party in such proceeding, or to conclusions or recommendations implementing those set forth in this Stipulation.

Staff-ComEd Joint Ex. 1, pp. 2-3 (Section I, par. 6). The Stipulation provisions providing that Staff “will not advocate that any conclusions or recommendations identified in the OCA Report should be adopted or ordered by the Commission in the Audit Docket or that any adjustments identified in the Audit Report should be made except as set forth in this Stipulation” in no way precludes the Commission from considering or ruling on other parties’ positions or arguments in the Audit Approval Docket or elsewhere.

The various citations to Staff’s testimony in this proceeding on these adjustments provide substantial record evidence for the Commission to approve the proposed set of issue resolutions contained in the Stipulation between Staff and ComEd. In addition, ComEd has offered evidence on these issues as well, which ComEd has discussed in its initial brief or, presumably, will discuss in its reply brief. Therefore, the AG and CUB’s arguments suggesting rejection of the resolutions proposed in the Stipulation should be rejected.

In addition to the agreements concerning the above-described revenue requirement adjustments, there are certain non-monetary conditions also agreed to between Staff and ComEd as set forth in the Stipulation. Staff-ComEd Joint Ex. 1, pp. 4-5 (Section II, par. 5, 4th and 5th bullets) and p. 6 (Section II, par. 10). These conditions

are commitments made by ComEd to provide notice of certain actions and perform a study, which commitments should be incorporated in the Commission's final order in this proceeding. Those commitments, one of which has a specific place in the uniform outline, are as follows:

1. "ComEd shall provide to the Manager of the Accounting Department at the Commission notice of ComEd's intent to change its (A) capitalization policy where such change is expected to result in an annual change in amounts capitalized of at least \$10 million or (B) Property Unit Catalog where such change is expected to result in an annual change in amounts capitalized of at least \$1 million, not less than 21 days prior to the date on which the change is implemented. By so agreeing, ComEd does not concede that it is obligated to provide any such notice outside of its agreement to do so in this Stipulation. The provision of this notice by ComEd as set forth herein shall not constitute approval of, consent to, or waiver of challenges or objections to such changes by Staff." Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 4th bullet). This particular adjustment is addressed in the outline in Section XI.A.
2. "ComEd shall conduct a study of its policy of including contractor labor costs in the base for loading of departmental overheads and shall provide a report regarding the results of such study to the Manager of the Accounting Department within 90 days of a final order in Docket No. 07-0566." Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 5th bullet).
3. "ComEd agrees to enter into discussions with Staff with the goal of explaining to Staff its current capitalization policy with respect to internal software, departmental overheads and the Property Unit Catalog (including, with respect to the Property Unit Catalog, time in the field)." Staff-ComEd Joint Ex. 1, p. 6 (II, par. 10)

Finally, there are two recommendations which ComEd has indicated it will not oppose in the Audit approval docket. The recommendations are:

1. ComEd shall "[r]eview and revise procedures and processes relating to the filing and storage of documents supporting the recording of transactions in the Plant Accounts and Reserves for Depreciation to enable prompt and efficient retrieval in connection with internal studies and for compliance with requests for information by regulatory agencies and their employees and

agents. (Refers to Chapter V Conclusion No. 5)". Staff-ComEd Joint Ex. 1, p. 2 (l, par. 5, 1st bullet)

2. ComEd shall "[r]eview and revise procedures and processes relating to the accounting for retirements so that the Company can clearly demonstrate that all retirements and related salvage credits are properly recorded in a timely manner. (Refers to Chapter V Conclusion No. 2)". Staff-ComEd Joint Ex. 1, p. 2 (l, par. 5, 2nd bullet)

Given that these agreements relate to conditions ComEd has agreed to accept and not oppose in the Audit Approval Docket, and do not have a specific dollar impact on rate base or the revenue requirement in this docket, those agreements need not be addressed further in this case but rather should be addressed in the Audit approval docket. Staff believes these conditions are beneficial to ratepayers, and would not expect the AG, CUB and any other intervenor to oppose these conditions in the Audit Approval Docket. Nevertheless, in the event that the AG, CUB or any other party opposes these conditions in the Audit Approval Docket, the Commission does not bind itself to accept these conditions by accepting the proposed set of issue resolutions contained in the Stipulation.

C. Contested Issues

1. Plant

b. Underground Cable and Services

ComEd's arguments against Staff's proposed \$111 million adjustment of underground cables and services are fundamentally flawed. The Company contends that its investments in this area are supported by "substantial documentary evidence" which Staff "ignored". ComEd IB, p. 20. Most importantly, in the Company's view, "Mr. Lazare admits that he has no evidence that any of these costs were imprudently

incurred or unreasonable in amount, the critical legal standards against which ComEd's costs must be judged." ComEd IB, pp. 20-21.

As these arguments clearly demonstrate, the Company seeks once again to ignore its burden of proof to establish the reasonableness of its costs and instead place the onus on Staff to prove the unreasonableness of those costs. Staff has clearly documented the Company's failure to support these investments. Nevertheless, in the Company's view, it is Staff's burden to prove that these unsupported numbers are unreasonable and should be removed from the Company's rate base. If ComEd's argument prevails, that will encourage ComEd and other Illinois utilities to provide even less support for costs in future proceedings, and then dare Staff and intervenors to demonstrate that their costs were unreasonable or imprudent. The Commission should send a strong signal that ComEd must clearly demonstrate why already burdened ratepayers should be asked to pay even higher rates for electric service.

Moreover, as the Illinois Supreme Court held in *People ex rel. Hartigan v. Illinois Commerce Comm'n*, 117 Ill. 2d 120, 131-136 (1987) ("*Hartigan I*"), it is not Staff's or Intervenor's burden to proof the unreasonableness of a utility's costs in the first instance; rather it is the utility's burden to proof the reasonableness of its costs. *Hartigan I* involved a direct appeal from a circuit court order reversing a Commission order finding certain costs for Unit 1 of ComEd's nuclear power plant near Byron, Illinois ("Byron 1") to be reasonable. *Id.* at 128-130. The circuit court had also "ruled that the Commission had improperly placed the burden of proof with the intervenors to show that Edison's costs were unreasonable, rather than requiring Edison to prove that the costs were reasonable." *Id.* at 129. The Illinois Supreme Court affirmed the circuit court's

ruling, rejecting the “approach of excluding costs from the rate base only if they were proved to be unreasonable” and specifically holding that “[r]equiring intervenors to establish unreasonableness is therefore no substitute for requiring proof of reasonableness.” *Id.* at 135-136.¹

While *Hartigan I* focused and relied upon the burden of establishing the reasonableness of generating plant costs under what was then Section 30.1 of the Public Utilities Act (now Section 9-213), the Supreme Court’s ruling was also based on its general reading of the Public Utilities Act and applies to costs other than generating plant. Specifically, after finding that the audit required by Section 30.1 replaced the presumption of reasonableness, the court found that the presumption of prudence was also invalid under the comprehensive scheme for regulation under the Public Utilities Act:

Furthermore, under the comprehensive scheme set out in the Public Utilities Act, the Commission is to be an active participant. The Commission is not merely an arbitrator between a utility seeking a rate increase and any parties who happen to oppose it. Rather, the Commission is an investigator and regulator of the utilities, and under

¹ Like its argument in the instant case, ComEd in *Hartigan I* relied upon case law establishing a presumption of prudence to argue that other parties were obligated to demonstrate the unreasonableness of its costs:

Edison points out that before section 30.1 was enacted, costs incurred by a utility were presumed to be reasonable (see, e.g., *City of Chicago v. Illinois Commerce Com.* (1985), 133 Ill. App. 3d 435, 442-43), and Edison argues that the enactment of section 30.1 did not eliminate that presumption. The Commission majority agreed with Edison that the historic presumption of reasonableness had survived the enactment of section 30.1. The majority believed that once a utility demonstrated the amounts that it had actually invested in the construction of a power plant, the investment was presumed to have been reasonable and the Commission was powerless to deny recovery of those costs unless there was some showing that they were unreasonably incurred.

Id. at 132.

section 30.1 it may not rely on intervening parties to contest a rate increase or to challenge the evidence offered by the utility.

Nothing in the Public Utilities Act requires any party other than the Commission and the utility seeking a rate increase to participate in a ratemaking proceeding. Thus, any participation by persons or groups opposing an increase is voluntary and purely fortuitous. It is possible that no person or entity will seek to intervene when a rate increase is sought; in other cases, those who intervene may lack the financial resources or the incentive to launch a vigorous challenge to all aspects of the increase. (See *Calvert Cliffs' Coordinating Committee, Inc. v. Atomic Energy Com.* (D.C. Cir. 1971), 449 F.2d 1109, 1118.) Requiring intervenors to establish unreasonableness is therefore no substitute for requiring proof of reasonableness. The difference is significant. In the case before us, in determining the reasonableness of the costs associated with the construction of Byron 1, it is apparent that in many instances the Commission relied on the now impermissible practice that costs are presumed to be reasonable once the utility has established the amount.

Because the Commission relied on the presumption of reasonableness, rather than an affirmative showing of reasonableness through the audit performed by ADL and specific evidence of reasonableness, the cause must be remanded to the Commission.

Id. at 135-136.

In *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 746-747 (1st Dist. 1995) ("*Citizens*"), the holding in *Hartigan I* was clearly applied to revenue requirement components other than generating plant. First, the court reviewed the burdens imposed on a utility in a rate case:

The utility bears the burden of proving that its proposed rates are just and reasonable. (220 ILCS 5/9-201(c) (1992).) To prove this the utility must prove the reasonableness of the values it places on the components of the revenue requirement. Thus, the utility must show that its operating costs are reasonable, its rate base is the reasonable value of its property used for serving the public, and its rate of return on capital is the reasonable cost of the capital needed to provide the services. See *Iowa-Illinois Gas*, 19 Ill. 2d at 445; *Candlewick Lake Utilities Co. v. Illinois Commerce Comm'n* (1983), 122 Ill. App. 3d 219, 222-23, 460 N.E.2d 1190, 77 Ill. Dec. 626.

Id. at 746. Then, the court found that Centel had not met its burden of establishing the reasonableness of its capital structure and, relying on *Hartigan I*, that the burden of establishing reasonableness had been improperly imposed on Intervenor:

As Centel conceded at oral argument, the order shows that the Commission found a reasonable likelihood that a different capital structure would permit Centel to meet its capital needs at lower cost. But this means Centel did not meet its burden of proving that the reported capital structure reflects capital costs reasonably necessary for the provision of services. The order contradicts the finding that Centel proved its proposed capital costs reasonable.

The order shows that the Commission based its approval of the capital structure primarily on its rejection of the evidence of manipulation CUB presented. Again, the Commission apparently acted as an impartial arbiter deciding which party presented the stronger argument. "Requiring intervenors to establish unreasonableness is *** no substitute for requiring proof of reasonableness." (*People v. ICC*, 117 Ill. 2d at 135-36.) **CUB's failure to prove manipulation of the capital structure is not sufficient to show that the reported capital structure provides an adequate basis for assessing Centel's cost of capital.**

Id. at 746-747 (emphasis added).

As the foregoing analysis indicates, ComEd arguments criticizing Staff for allegedly failing to establish the unreasonableness or imprudence of ComEd's cost fail as a matter of law. Those arguments also fail under the record evidence.

ComEd insists that it has met its evidentiary burden on underground lines and services. ComEd IB, pp. 21-22. However, it identifies little evidence to support its proposed additions in these areas. ComEd cites statements by Company witness Williams that these additions are "used and useful". However, this is an unsupported conclusory statement by a Company employee who began his tenure in August 2006. Tr. 764. The lack of on-the-job experience raises questions about the depth of his knowledge of the distribution system and his ability to reach conclusions about the extent to which rate base is used and useful.

The Company does cite testimony by Mr. Williams concerning the “escalating prices of labor and materials” for underground cable and services. ComEd IB, p. 21. The only relevant costs presented from those passages cited are the costs of underground and overhead cables. Furthermore, those increases account for grand totals of \$2,600 and \$2,800 in costs per mile for underground and overhead lines, respectively. (ComEd Ex. 4.0, 2nd Corrected, pp. 36-37:717-718) So, for example, the Company’s average cost of 2005 and 2006 additions per mile runs to \$245,170 for underground lines (ICC Staff Ex. 5.0, Schedule 5.2, p. 2 of 2), which means that the unit underground cable costs cited by Mr. Williams amount to just over one percent of these additions costs. This leaves almost 99 percent of these costs unexplained by the Company.

ComEd then refers to an analysis which indicates that “between January 2004 and January 2007, utilities across the country experienced a 34% increase in distribution plant costs.” ComEd IB, p. 22. The implication is that this utility-wide increase somehow justifies the proposed plant additions for underground lines and services. Missing from the Company’s argument is any explanation why this figure demonstrates the reasonableness of ComEd’s proposed 2005 and 2006 additions for underground lines and services. Furthermore, the fact that this industry-wide survey is the only numerical support the Company can unearth testifies to the lack of concrete evidence for ComEd’s proposed plant additions.

The third piece of evidence cited by ComEd is a statement that the Company “has controls in place to ensure that plant investments – including in cable and services – are necessary, and that the work is completed efficiently and at least cost.” ComEd IB,

p. 22. Again, this statement amounts to an unsupported assurance from ComEd that its costs are reasonable. These kinds of testimonials from the Company fall short of meeting the evidentiary burden to demonstrate that costs are reasonable.

This discussion by the Company underscores the reasonableness of Staff's proposed adjustment of underground lines and services. The heading for this section of ComEd's Initial Brief states that "ComEd has met its evidentiary burden". ComEd IB, p. 21. However, the discussion itself is bereft of evidence to support its plant additions. The only conclusion to draw from this discussion is that the Company has failed to meet its evidentiary burden and its plant additions in these areas are almost entirely unsupported. While this deficiency could justify a much larger adjustment, Staff chose instead a more limited adjustment that provides the Company reasonable increases in both materials and non-materials costs.

After having provided a dearth of evidence in support of its proposed additions, the Company turns around and argues that those unsupported additions may be disallowed under only narrow and limited circumstances. According to ComEd, "it has long been the law in Illinois that, once a utility presents a *prima facie* case establishing 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*, 327 Ill. App. 3d 768, 776 (3d Dist. 2002); *City of Chicago v. Cook County*, 133 Ill. App. 3d 435, 442-443 (1st Dist. 1985)." ComEd IB, p. 23. While Staff does not dispute that the burden of production may shift between the parties, ComEd's assertion that it becomes Staff's or

Intervenors' burden to show the unreasonableness of ComEd's costs is contrary to *Hartigan I* and *Citizens* as discussed above.

Section 9-201 of the Public Utilities Act specifically provides that in any hearing to determine the propriety of any proposed rate, charge, practice, rule or regulation "the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility." (220 ILCS 5/9-201(c)) While the burden of proof is often regarded as the burden of persuading the trier of fact on each element of a claim, it is actually a two-pronged concept consisting of the burden of persuasion and the burden of producing evidence sufficient to make out a prima facie case. The second prong is generally referred to as the "burden of production," the "burden of producing evidence" or the "burden of going forward" on an issue. (See *Consolidated Communications Consultant Serv., Inc. v. Illinois Bell Tel. Co.*, Docket 99-0429, 2001 Ill. PUC LEXIS 568, *12-14 (June 4, 2001) (explaining the two-fold nature of the burden of proof))

The standard for a making out a prima facie case in Illinois can generally be stated as the requirement to provide at least some evidence on every element of the underlying cause of action. *Sherman v. Cryns*, 203 Ill. 2d 264, 275 (2003) ("A plaintiff establishes a prima facie case by proffering at least 'some evidence on every element essential to [the plaintiff's underlying] cause of action.'"); *Happel v. Mecklenburger*, 101 Ill. App. 3d 107, 111 (1st Dist 1981) ("The plaintiff must have presented some evidence, more than a scintilla, on every essential element of his cause of action."). While a rate case is not a cause of action with a specific set of elements uniformly applicable in every case, a utility must establish "that its operating costs are reasonable, its rate base

is the reasonable value of its property used for serving the public, and its rate of return on capital is the reasonable cost of the capital needed to provide the services.” *Citizens*, 276 Ill. App. 3d at 746. Moreover, a utility’s rate base may only include “the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.” 220 ILCS 5/9-211. Indeed, the Legislature has declared that one of the goals and objectives of public utility regulation is to ensure that rates for the sale of various public utility services “accurately reflect the cost of delivering those services and allow utilities to recover the total costs prudently and reasonably incurred.” 220 ILCS 5/1-102(a)(iv). Thus, once specific issues are identified based on the facts and circumstances presented in a rate case, a utility is obligated to produce sufficient evidence on that issue to meet its burden of production. If a utility fails to meet this burden by producing no evidence on a specific issue, then the Commission should rule against the utility on that issue for failure to satisfy its burden of production and burden of persuasion. Cf. *Sherman*, 203 Ill. 2d at 275.

The flaw in the Company’s argument is that it has not presented a *prima facie* case as the short, inconsequential discussion in ComEd’s Initial Brief further attests. Furthermore, the Company admits it has not provided overall information on either materials or labor costs associated with plant additions. For example, Company witness Williams does not know the amount of materials cost associated with the proposed 2005 plant additions for Account 366, Underground Conduit and Account 367, Underground Conductors and Devices. Tr. 734:8-13. He also admits he has not provided for the record a breakdown of services costs between material and labor. Tr.

740:9-18. In addition, when asked specifically about the component of plant additions represented by capitalized labor costs, Mr. Williams acknowledged, “We don't break out specifically the labor costs itself.” Tr. 738:18-19.

These deficiencies are critical given Mr. Williams’ statement that ComEd’s costs to install new underground lines and new services have increased “partly due to the higher cost of materials, and partly due to the higher cost of labor.” ComEd Ex. 22.0 (2nd Corrected), 4:81-82. ComEd’s failure to provide materials or labor costs associated with plant additions means that the prime drivers of these cost increases cannot be assessed., and a finding of reasonableness for ComEd’s requested increases for underground cables and services cannot be made.

The only way for ComEd to divert attention from its own shortcomings is to attack the basis for Staff’s alternative. Based on the faulty assumption that ComEd has satisfactorily supported its case, the Company takes Staff to task for not finding specific problems with its proposed plant additions. For example, ComEd claims that Staff has not identified “any component of ComEd’s non-material costs were imprudently acquired or unreasonable in amount.” ComEd IB, p. 23. The problem is that when ComEd provides virtually no cost information, that means there are no costs to identify as imprudent or unreasonable. For example, ComEd has admitted that it does not break out the labor costs associated with plant additions. Thus, it is difficult to discern whether these unknown costs are imprudent or unreasonable. The same holds true for materials costs. ComEd’s failure to identify materials costs makes it difficult to state positively that the Company could have purchased or acquired those materials at a lower cost.

Nevertheless, ComEd takes Staff to task for failing to identify specific problems with these unknown costs. ComEd IB, pp. 23-24.

ComEd further takes Staff witness Lazare to task for not making sufficient use of the available information resources in preparing his adjustment. The Company complains that Mr. Lazare visited ComEd's Springfield data room on only one occasion and notes that he did not participate in the Rate Case Field audit. ComEd also complains that during his visit to the Springfield data room Mr. Lazare "could not remember reviewing any plant addition files". According to the Company, these files included reports by a consulting firm, Power Delivery Research and Consulting Corp., which provided directly relevant information concerning the accounts Staff proposes to adjust. ComEd IB, pp. 24-25.

This argument is flawed in two respects. First, what activities Mr. Lazare did or did not undertake in addressing the issues in this case is irrelevant to whether the Company met its burden of proof. The only relevant matter is the evidence placed on the record and whether that evidence warrants a downward adjustment in this case. The fact that ComEd wishes to discuss the fact that Mr. Lazare did not participate in a field audit in Chicago should appropriately be construed as an effort to divert attention away from the evidentiary record in this case.

In addition, ComEd provides no proof for its insinuation that the Data Room contains conclusive evidence to undermine Staff's proposed adjustments. If the reports cited by ComEd do, in fact, undermine Staff's position, then it is the Company's responsibility to make that showing. However, ComEd has failed to do so in this case.

Furthermore, ComEd complains that the Staff who participated in the field audit failed to recommend any adjustments concerning underground cable or services. ComEd IB, p. 25. The implication is that these are the only Staff who should have the right to adjust these accounts. Thus, ComEd apparently asserts the right to decide who on Staff should be allowed to recommend adjustments to its costs. ComEd's assertion in this regard is nothing more than a red herring. The basis upon which Staff assigns tasks or issues to various Staff members is of no concern to ComEd, and certainly has no bearing on the validity of adjustments proposed by Staff.

The Company proceeds to criticize how Staff's proposed adjustment of underground lines and services was developed. One complaint is that Staff focuses on "meaningless" unit costs, rather than the "real costs of real projects". ComEd IB, p. 26. ComEd's argument is deficient in two respects. For one, the unit cost derived by Staff are based on the only cost information provided by ComEd. As previously noted, the Company failed to break down their proposed additions into materials or capitalized labor cost components. Thus, there was a dearth of cost information on which to develop a cost analysis. Nevertheless, Staff relied on the information that was available to develop its adjustment. This is the most reasonable approach given the level of available data.

Furthermore, ComEd's invocation of the term "real costs" refers to the fundamentally flawed cost analysis presented in Mr. Williams' rebuttal testimony. Mr. Williams demonstrated in the hearing process that these costs are inappropriate to use for assessing plant additions. According to Mr. Williams, the "real costs" of underground lines "are average cumulative numbers, not numbers representative of additions each

year”. Tr. 758:8-759:11. Furthermore, Mr. Williams agreed that to examine the “new or additional cost” associated with the unit costs from ComEd’s distribution data book, it is necessary to take the difference in the cumulative figures he presents divided by the miles of additional cable. Furthermore, Mr. Williams agreed that this would produce a unit cost of \$359,000 per mile of additional cable, which is far higher than the \$105,022 cumulative average mile presented in his rebuttal testimony. Tr. 760:4-762:5. Thus, the “real costs” used by Mr. Williams is irrelevant for assessing Staff’s proposed adjustment.

The Company goes on to restate Mr. Williams’ argument that Changes in Mr. Lazare’s calculated “unit cost” do not track changes in the unit cost of the underground cable or services.” ComEd IB, pp. 26-27. However, as has previously been discussed, Mr. Williams’ concept of “unit costs” is problematic for the purpose of evaluating plant additions. The Company goes on to argue that if Staff had used a shorter period for its analysis, the results would have produced a smaller increase in average unit costs for underground cable, reducing Staff’s adjustment by 75%. According to the Company, “No “methodology” that produces such wildly fluctuating results based on changing a single arbitrarily chosen input can be deemed reliable.” The Company goes on to state, “Albeit in a slightly different context, Mr. Lazare himself stated in his direct testimony: “The use of older data produces a less precise picture of the current state of ComEd’s system. This can be significant since assets are being retired as well as added.” ComEd IB, pp. 27-28.

These arguments present a number of problems. For one, there is nothing arbitrary in the analysis performed by Staff. That analysis sought to determine the trend in underground lines and services costs over time. The larger the period of time

assessed, the better the trend in costs can be assessed. As Staff witness Lazare stated, “I think that in this case a broader range is preferable to a shorter period in order to prevent any one atypical year from skewing the results.” Tr. 1751:9-12. ComEd’s effort to shorten the time period arbitrarily limits the trend being analyzed.

It is also worth noting that ComEd limits its discussion to perceived problems with the analysis for underground cable. The fact that it did not present a complementary analysis for services suggests that ComEd could not derive similar favorable results by massaging the data for this cost account.

Furthermore, the fact remains that Staff’s proposal reflects the most reasonable assumptions about plant additions costs for underground lines and services in this case. The basis for Staff’s approach is well laid out in Mr. Lazare’s testimony. In contrast, the Company’s proposed additions lack support or justification. In this situation, Staff has presented the most reasonable approach.

It should be noted that ComEd discusses for a second time in its Initial Brief the study which found that utilities across the country “experienced a 34% increase in distribution plant costs between January 2004 and January 2007. ComEd IB, p. 28. While this reference has already been addressed in this reply brief, the fact that ComEd dredges this number up once again testifies to the Company’s failure to provide support for its proposed plant additions in this case.

For all the foregoing reasons, Staff’s proposed adjustment to underground cables and services should be adopted by the Commission.

e. Depreciable Life of Post-2006 Project

The Commission should accept Staff's adjustment to amortize the cost of ComEd's Post-2006 Rate and Billing Project ("Post-2006 Project") over ten years rather than the five years proposed by ComEd. Staff presented a reasonable and fair analysis of ComEd's information technology ("IT") costs in this case. Staff conducted extensive discovery on the IT issues. See Attachment E to ICC Staff Exhibit 1.0. Notably, Staff withdrew its adjustment to normalize ComEd's IT costs once it received ComEd's rebuttal testimony and further discovery on the issue. As to the appropriate amortization period for the Post-2006 IT project, Staff recognizes that ComEd's general policy for IT projects is five years. ComEd IB at p. 31. Staff makes no attempt to change that general policy. Staff's recommendation is specific to the Post-2006 project and does not relate to all other capitalized IT project costs.

The Post-2006 project was not of ordinary scale or scope, and it was one of the top five additions to plant in service since ComEd's last rate case. Staff IB at pp. 27-28. Staff recognizes that ComEd's IT system may be affected in some manner by the Illinois Power Agency. ComEd IB at p. 31. However, there is no evidence in this case of any changes on the horizon that will render the extensive programming changes implemented under the Post-2006 project useless after five years. ComEd's statement that the Post-2006 project will become obsolete in a relatively short period of time (ComEd IB at 31) is nothing more than speculation. . Staff's recommendation should be adopted by the Commission.

2. Accumulated Provisions for Depreciation and Amortization

The AG, in its discussion of the Staff and ComEd Stipulation, takes issue with Staff for withdrawing its proposal to adjust plant in service and accumulated depreciation balances to the actual amounts known on December 31, 2007. AG IB, p. 5. In addition to the response set forth below, Staff incorporates its response to this issue set forth in Section IV.B.1.e above. Staff originally proposed these adjustments in Staff witness Griffin's direct testimony. The bases for Mr. Griffin's adjustments were that ComEd originally proposed pro forma additions for a twenty-one month period which included all of 2007 and the first three quarters of 2008. Mr. Griffin explained that because actual amounts for 2007 were known, the Company's pro forma adjustments should not produce a result that was inconsistent with the actual operating results for which the pro forma adjustments were intended to represent. For that reason, he proposed adjusting plant in service and accumulated depreciation to the balances actually in existence on December 31, 2007. ICC Staff Exhibit 2.0 Corrected, pp. 7-8.

The AG argues that by not making this adjustment the Commission's rule on pro forma adjustments would be violated. AG IB, p. 5. CUB makes the same argument as well. CUB IB, pp. 5-6. It was not Mr. Griffin's position that his adjustment was necessary to comply with the Commission's rule on pro forma adjustments. Mr. Griffin never made such a claim in his testimony. The AG's brief ignores Staff witness Griffin's rebuttal testimony wherein he explained the basis for withdrawing the adjustment. Staff witness Griffin originally proposed the adjustment because in his opinion ComEd was proposing a comprehensive restatement of its plant balance from the end of the 2006 test year forward 21 months to September 31, 2008. Mr. Griffin proposed his adjustment to mitigate the shift in the test year from December 31, 2006 to September

31, 2008. ICC Staff Exhibit 15.0 Corrected, pp. 8-9. Mr. Griffin further testified that he withdrew his adjustment given that ComEd agreed as part of the Stipulation to limit its pro forma adjustments to plant additions through June 30, 2008. *Id.*, p. 9. Given this change, Mr. Griffin found the Company's pro forma adjustment to no longer be a comprehensive restatement of the plant balance. *Id.* Because there was no longer a comprehensive restatement of plant balances, Mr. Griffin found the adjustment to no longer be necessary. Staff would add, as discussed in its initial brief, Mr. Griffin testified that the pro form adjustments though June 30, 2008 agreed to by ComEd in the Stipulation are reasonable and meet the known and measureable standard of 83 Ill. Adm. Cod 287.40. Staff IB, pp. 11-13.

V. OPERATING EXPENSES

C. Contested Issues

1. Incentive Compensation Cost and Expenses

Staff maintains that the amounts reflected on page 34 of Staff's Initial Brief should be disallowed from the revenue requirement approved in this case. ComEd contends that Staff's adjustments are inconsistent with prior Commission orders. ComEd IB at p. 42. To the contrary, Staff's proposed adjustments are consistent with prior Commission rulings that rates should not include incentive compensation costs based on goals that benefit shareholders rather than ratepayers.

ComEd begins by ignoring the substantive bases for Staff's proposed adjustments to inappropriately assert that "uncontested evidence" shows that its total compensation is prudently incurred and reasonable in amount. ComEd IB at 41.

Whether specific costs were “prudently incurred” or would result in “just and reasonable rates” if included in a utility’s revenue requirement are, of course, legal conclusions rather than matters of fact. Moreover, Staff’s position is that these costs do not constitute prudently incurred costs for purposes of establishing just and reasonable rates because they are intended to benefit shareholders and have not been shown to provide tangible benefits to ratepayer.

ComEd’s argument also reflects a truncated and incomplete view of ratemaking principles. The law does not require the Commission to set rates which recover all costs of service posited by a utility. Section 9-101 of the Public Utilities Act (the “Act or “PUA”), 220 ILCS 5/9-201, requires that rates and charges for services shall be just and reasonable. Pursuant to this statutory mandate, the Commission and the courts have found that a number of utility expenses (including expenses otherwise reasonable from a business perspective) should not be included in rates. The longstanding rule is that “the public is entitled to demand that no more be exacted from it than the services rendered are reasonably worth.” *Public Utilities Commission v. Springfield Gas*, 291 Ill. 209, 217 (1920).

In *Illinois Bell Telephone v. Illinois Commerce Comm’n*, 55 Ill. 2d 461, 478-481 (1973), the court held that Illinois Bell was precluded from recovering expenses for lobbying, charity, civic and social club dues, and an unreasonably high licensing fee paid to A T & T. Similarly, in *DuPage Utility v. Illinois Commerce Comm’n*, 47 Ill. 2d 550, 560-561 (1971), the court upheld the Commission’s disallowance of one half of the annual salaries of three officers of the utility found to be excessive and out of proportion to the nature and extent of the services rendered. In *Candlewick Lake Utility v. Illinois*

Commerce Commission, 122 Ill. App. 3d 219, 227 (2nd Dist. 1984), the court, citing the *Illinois Bell* decision, held that a "utility has the burden of proving that any operating expense for which it seeks reimbursement directly benefits the ratepayers of the services which the utility renders." Thus, expenses are recoverable only when the utility can prove them to be reasonable, related to utility services, and of benefit to ratepayers or utility service. The showing required by the Commission for incentive compensation costs to be included in rates fits squarely within these ratemaking principles and is reasonable, and the Company's arguments to the contrary must be rejected.

a. Annual Incentive Plan ("AIP")

i. Financial Net Income Goal

As explained in Staff's Initial Brief, ComEd's request to recover costs related to the financial net income goal must be denied because that goal primarily benefits shareholders. Staff IB, pp. 34-37. ComEd has not raised any new arguments on this issue in its Initial Brief, and Staff has already explained that the Commission has rejected similar arguments in connection with ComEd's earnings per share goal in its last rate case. Staff IB, p. 35. Thus, the Commission has recognized the problem with placing in rates a cost which is a reward for accomplishing a financial metric which will be improved by simply including such costs in rates. ComEd's response to this circular reasoning issue (ComEd IB at p. 45) is little more than a re-hash of various company arguments on various incentive compensation plans' financial goals that have time and again been rejected by this Commission. Staff IB at pp. 36-37. ComEd has not addressed the fact that its net income goals are financially based and, therefore, primarily result in shareholder benefits.

For all the foregoing reasons, Staff's proposed adjustment to this component of the AIP should be adopted by the Commission.

ii. Total Cost Goal

Staff maintains that its proposal in this case to allow only 50% of the cost of the AIP Total Cost goal is a reasonable approach to a goal which results in both shareholder and ratepayers benefits, and represents an option which was not presented to the Commission in ComEd's last rate case. Staff IB, pp. 37-39. ComEd refuses to acknowledge any benefit to shareholders from accomplishing lower operating and maintenance ("O&M") costs between rate cases, but rather relies only on its "we got it last time" argument. ComEd IB, pp. 43-45. ComEd's refusal to acknowledge the obvious shareholder benefits of this goal and Staff's reasonable proposal is telling. Because the Commission can deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or same situation previously (Mississippi River Fuel Corp. v. Illinois Commerce Commission, 1 Ill.2d 509, 513), the Commission has the discretion to consider Staff's arguments. ComEd's refusal to acknowledge *any* shareholder benefits from its Total Cost goal is self-serving and must be rejected by the Commission.

b. Long Term Incentive Plan ("LTIP")

In disagreeing with Staff (and the IIEC's) proposed adjustments to the LTIP, ComEd states "The Commission consistently has approved ComEd incentive compensation amounts associated with reliability metrics." ComEd IB at 47. ComEd's statement is misplaced. Staff's adjustment to the LTIP is not based on *any* goals related to accomplishment of reliability metrics. Staff's adjustment relates solely to the

one-third of the LTIP based upon financial goals and another one-third based upon legislative and regulatory goals. Staff IB, pp. 39-40. The problems with incentive compensation financial goals such as those at issue here have been thoroughly established in Staff's IB and above. Staff IB, pp. 40-41; 34-37.

ComEd's IB also quotes a portion of its rebuttal testimony wherein ComEd misrepresents Staff's position concerning the rationale for disallowing the portion of the LTIP relating to regulatory and legislative goals. ComEd asserts that Staff is against the timely recovery of prudently incurred costs. ComEd IB at 48. As argued in Staff's testimony, Staff's concern is not with appropriate and timely recovery of prudent costs, but rather that under the goals of the LTIP ratepayers would pay an incentive to ComEd to file more frequent rate cases, or to achieve results in those rate cases more favorable to ComEd, which in turn does nothing to benefit ratepayers. Staff IB at 40. ComEd has not provided this Commission with any evidence that its LTIP legislative and regulatory goals, which essentially reward ComEd for filing rate cases and proposing new rate riders, benefit ratepayers. Therefore, these costs must be disallowed.

4. Administrative and General (A&G) Expenses

c. Rate Case Expenses

ii. 2005 Rate Case Expenses in the 2006 Test Year

As set forth in Staff's Initial Brief, Staff witness Griffin disallowed 2005 rate case costs (\$3,143,000 (ICC Staff Exhibit 2.0, Schedule 2.8)) that were in excess of the rate case expense amount approved by the Commission in the Company's last rate proceeding, Docket No. 05-0597. Staff IB, pp. 43-46. Mr. Griffin took issue with the

Company being allowed to true-up its prior rate case expense to actual amounts incurred. ICC Staff Exhibit 2.0 Corrected, p. 18. As Mr. Griffin explained, this amount was in excess of the amount of expense previously approved by the Commission and “[i]t would be inappropriate to recover these costs retroactively in this case.” ICC Staff Exhibit 15.0 Corrected, p. 15. Mr. Griffin did not take issue with the prior Commission-approved rate case expense amount being recovered in future cases such as this case if the full amount had not yet been amortized by the time a utility files its next rate case. Staff IB, p. 44.

In its initial brief, ComEd first responds to AG witness Mr. Efron’s argument that the amount should not be allowed because it is retroactive ratemaking. ComEd then responds to Staff by arguing that Mr. Griffin’s position on this issue is simply that recovery is not allowed because he was “ ‘unaware of any Commission order allowing a Company to include as costs in the unamortized balance of its prior rate case costs that are in excess of the level approved by the Commission in that case.’ ” ComEd IB, p. 57. ComEd misunderstands Staff’s position on this issue. As implied in Mr. Griffin’s testimony (ICC Staff Exhibit 15.0 Corrected, p. 15) and set forth in Staff’s Initial Brief, allowing ComEd to “true up its prior rate case expense” would constitute retroactive ratemaking. Staff IB, p. 44.

ComEd’s only response in its initial brief to the retroactive ratemaking argument is to cite to the cross examination of Mr. Efron, wherein Mr. Efron testified that he understood that in this case “ComEd is not seeking recovery of those costs under some theory that in 2006 its rates were too low?”. Tr. at 585:11-15 (emphasis added); ComEd IB, p. 57. Whether ComEd has stated in its pleadings or testimony that it is or is not

seeking recovery of the expenses “under some theory that in 2006 its rates were too low.” is irrelevant. What is at issue is whether ComEd’s proposed recovery of these additional rate case expenses would constitute retroactive ratemaking, which it would.

Staff’s Initial Brief fully addressed the retroactive ratemaking issue. As set forth in Staff’s Initial Brief, ComEd acknowledges that the Commission in its 2005 rate case only allowed it to recover \$7,315,000 in rate case expense, but in this case ComEd now wants the Commission to allow it to recover an additional \$1,048,000 in 2005 rate case expense (\$3,143,000 in total) because that additional amount is now known and has been incurred. ComEd Ex. 25.0 Corrected, p. 62. Whether intended or not, the real effect of ComEd’s proposal to recover additional 2005 rate case expense is to increase retroactively the amount of 2005 rate case expense previously allowed by the Commission, and the Commission should now allow ComEd to recover an additional amount equal to its incremental actual 2005 rate case expenses incurred in 2006. The Supreme Court has held that “the Act does not permit retroactive ratemaking; that is, the law prohibits refunds when rates are too high and surcharges when rates are too low. *Citizens Utilities Co. v. Illinois Commerce Comm’n* (1988)” *BPI I*, 136 Ill. 2d 192, 209 (1989). To allow ComEd to recover incremental 2005 rate case expense actually incurred in 2006 would be a surcharge to the rates previously approved by the Commission for 2005 rate case expense.

ComEd’s theory/argument in support of recovery is that the costs were prudently incurred reasonable expenses incurred during the test year. ComEd IB, p. 58. As Staff addressed in its Initial Brief, ComEd’s argument that these additional 2005 rate case amounts were incurred during the test year fails to consider that ComEd in its prior rate

case and its current rate case has chosen to seek recovery of rate case expense based upon an amortized amount of rate case expense for its 2005 rate case rather than actual rate case expense incurred in the test year. If ComEd wants recovery for the rate case expense actually incurred during the test year, i.e. 2006, then it cannot at the same time seek recovery of unamortized rate case expenses which have not been incurred during the test year. That is, there could be no recovery of the unamortized 2005 rate case expenses incurred prior to the test year and no recovery of the rate case expenses for the current docket incurred subsequent to the test year. Staff's position on this issue is both fair and reasonable and should be accepted by the Commission. To adopt ComEd's position would be contrary to law.

ComEd also argues that the 2005 rate case expense costs incurred in 2006 which Mr. Griffin disallows are:

costs that because of timing, ComEd was unable to prove as "actuals" at the time it provided its rate case expense forecasts in the 05-0597 rate case. Indeed, in that case, ComEd provided estimates of these remaining costs, which the Commission disallowed **because they were not yet actuals**. If ComEd is prohibited from recovering costs when they are estimates, as in 05-0597, and is also prohibited from recovering those costs as actual test year expenses, the Commission will be improperly disallowing costs that no one has suggested were imprudent or unreasonable in the first instance.

ComEd IB, pp. 57-58 (emphasis added). Contrary to ComEd's argument, the Commission never ruled that it was disallowing estimated 2005 rate case expenses in Docket No. 05-0597 based on a ruling that only "actual" rate case expenses are recoverable.

First, the Commission's order in Docket No. 05-0597 contains no such ruling. With respect to Staff's rate case expense adjustment in Docket No. 05-0597, the Commission stated as follows:

Before we address the issue of which recovery mechanism is most appropriate for procurement case expenses, the Commission will adjust Administrative and General expense ... to reduce the rate case expense to be recovered by ComEd by Staff's proposed adjustment of \$626,000 ... because we agree with Staff that these amounts were not fully substantiated by ComEd.

Commonwealth Edison Co., ICC Docket No. 05-0597, (Final Order, July 26, 2006), at 47 ("05-0597 Final Order"). The 05-0597 Final Order nowhere indicates that the rate case expense adjustment adopted by the Commission was based on the rejection of estimated costs because they were not yet actuals.

ComEd's assertion is also incorrect. ComEd's interpretation of the 05-0597 Final Order relies upon the rebuttal panel testimony of Mses. Houtsma and Frank. In their testimony, Mses. Houtsma and Frank argue that the Commission decision in the 2005 case "appears to have been made based upon the amounts that could be supported with actual expenses." ComEd Ex. 25.0 Corr., 62:1298-1299. In support, Mses. Houtsma and Frank refer to Ms. Hathhorn's testimony in the 2005 rate case where she stated that her rate case expense adjustment disallows "estimated amounts 'not yet substantiated by ComEd.' Staff Ex. 12.0, p. 20, lines 424-426." ComEd Ex. 25.0 Corrected, p. 62. This reference does not support their argument regarding actuals.

Moreover, Ms. Hathhorn's testimony in Docket 05-0597 made clear that the amount of rate case expense she allowed was not limited to amounts that could be supported with actual expenses:

I note that my Schedule 12.12, page 2, though, is updated through January 2006 actual expenses with the remainder of 2006 expenses estimated. Further, my adjustment does not disallow estimated amounts for external legal costs expected through the end of this proceeding

ICC Staff Exhibit 12.0 (Docket 05-0597), 23:500-504 (http://www.icc.illinois.gov/e-docket/reports/view_file.asp?intldFile=165072&strC=bd) Indeed, Mses. Houtsma and

Frank admit that Staff's adjusted 2005 rate case expense included estimated expenses for 2006 (and was not an adjustment limiting ComEd to actual costs incurred) when they testify that "In that proceeding [05-0597], the Commission used Staff's estimates for 2006 costs associated with a number of rate case expenses, based upon actual amounts incurred in 2005." ComEd Ex. 25.0 Corr., 61:1280-1282.

ComEd's argument should be rejected. ComEd has misinterpreted both the Commission's conclusion in the 2005 order and Staff witness Hathhorn's testimony on the issue. The costs at issue in the 2005 rate case were not disallowed because ComEd failed to provide "actuals". ComEd can cite to no language in the 05-0597 Final Order to support that assertion. Rather, the Commission disallowed the costs because the Commission agreed with Staff witness Hathhorn that the costs were not fully substantiated by ComEd. 05-0597 Final Order at 47. As is evident from the language in the order, the Commission's conclusion on this issue was based upon the testimony of Staff witness Hathhorn and her adjustment. As previously discussed, Mses. Houtsma and Frank note in their testimony that Ms. Hathhorn found a certain amount of the estimated amounts to be unsubstantiated. However, no where in their testimony do they cite to testimony by Ms Hathhorn in the 2005 rate case where Ms. Hathhorn testifies that an unsubstantiated expense is simply one which for which there are no actuals.

There is no credible basis to find that Ms. Hathhorn (or the Commission) only considered actuals. In fact, such a position would be inconsistent with the position Staff has taken in this case. In this case, Mr. Griffin allowed 2007 rate case expenses greater than actuals incurred by ComEd. ICC Staff Exhibit 15.0 Corrected, p. 12. For

ComEd to suggest that Staff took a contrary position in the prior case is not credible. ComEd witnesses Houtsma and Frank make that assumption, but that assumption is incorrect. ComEd argument in this case that the Commission in the 2005 order disallowed the estimated 2006 costs because they were not yet actual is based on a false assumption and must be denied.

For all the foregoing reasons, Staff's proposal to disallow ComEd's request for 2005 rate case expense in excess of the 2005 rate case expense amount approved by the Commission in the Company's last rate proceeding should be adopted.

VI. RATE OF RETURN

C. Cost of Common Equity

Staff maintains that the Commission should adopt Staff's 10.30% estimate of the investor-required rate of return on common equity for ComEd's electric delivery rates. Staff IB, pp. 47-52.

1. Response to ComEd's Initial Brief

In its Initial Brief, ComEd argues that the Commission should adopt its 10.75% cost of equity recommendation or, in the alternative, adopt an update of Staff's cost of equity recommendation, which it alleges to be 10.65%. ComEd RB, p. 64. As explained in Staff's Initial Brief, ComEd's 10.75% estimate is based on flawed analyses (Dr. Hadaway's use of unsustainably high growth rates in his DCF analysis, Dr. Hadaway's various risk premium analysis flaws, and Dr. Hadaway's arbitrary and inconsistent weighting of his cost of equity models to reach his final recommendation) and should be rejected. Staff IB, pp. 53-57. In addition to those general methodological

flaws, the Company's update of its own cost of equity estimate is unreliable. First, the Company failed to specify the dates for the analyst growth rates employed. ComEd Exhibit 29.06. Thus, based upon the record evidence the Commission does not know if the more recent analysis was fully updated or if all of the data was updated to a consistent date. Second, Dr. Hadaway's quarterly discounted cash flow ("DCF") model estimate of 11.1%, which represents the high-end of the range from which his cost of equity is drawn, includes individual returns on equity ("ROEs") as high as 15.1%, 15.3%, and 17.6%, which are clearly out of line with the other individual ROEs and any reasonable estimate for ComEd.² The removal of those three estimates would decrease the mean ROE for his quarterly DCF model considerably, from 11.1% to 10.4%. Further, with that correction, six of the seven analyses Dr. Hadaway updated produced lower updated results than their original estimates. Yet, Dr. Hadaway concludes that both his original and updated analysis indicate the same 10.75% cost of equity. Such inconsistencies raise serious questions as to the value of the updates he proposes.

With respect to ComEd's "update" of Staff's proposal, it, too, is flawed, as the Company chose to update only selected portions of Staff's analysis. Specifically, Company witness Hadaway failed to update the Zacks growth rates for Staff's DCF analyses or the betas employed in Staff's CAPM analysis. ComEd Exhibit 42.2. Those key inputs are the two most contentious factors in those models. If an update were necessary, and it is not, it is unreasonable to update certain inputs, but fail to update all

² Those three estimates are 1.69, 1.77, and 2.74 standard deviations above the average, respectively. Without those estimates, the standard deviation falls from 2.38% to 1.47%, which indicates that the remaining individual estimates are relatively tightly distributed, while those three high estimates are significant outliers.

inputs, particularly two of the most critical inputs. Indeed, the very reason the Company proposes an update, is because inputs (such as growth rates and betas) change. Thus, the Company cannot accurately claim that its “update” reflects what Staff’s cost of equity estimate would have been if performed on February 14, 2008. In fact, that “updated” estimate is of no value in determining ComEd’s cost of equity, as it does not represent the cost of equity at any single time.

Moreover, Staff does not endorse the allowance of updates in later rounds of testimony, unless good cause is shown (i.e., not simply for the sake of increasing the revenue requirement, such as ComEd is proposing). From a policy perspective, the allowance of *optional* updating from case to case would encourage utilities to selectively update only in proceedings in which, or only those factors for which, such updates would increase the cost of capital. The end result would be upward updating but no downward updating to cost of equity estimates by utilities. More generally, Staff does not endorse updating in later rounds of testimony, whether optional or compulsory, because the period allotted for responsive testimony typically does not provide the time needed to verify the accuracy of the updates and evaluate the impact of those updates on capital structure balances and the embedded costs of debt and preferred stock. The period allotted for responsive testimony is simply not the proper time to change a primary case.

The Company did not provide sufficient justification for altering the parties’ primary cases during a responsive phase of the proceeding. The Company’s rationale that an update would reflect the more recent market data used to support Staff’s Ameren recommendation is without merit. ComEd IB, p. 63. First, obviously, any

update would reflect more recent data; that is true at every phase of the proceeding. However, to update at every phase of the proceeding is impractical. Nevertheless, if updates proposed simply for the sake of updating are allowed, the sponsor should update **all** of the components of the cost of capital. Such an update ensures that the components of the cost of capital are measure consistently in order to avoid selective component updates that may distort the cost of capital. Since ComEd did not update all of the cost of capital components – indeed, it did not even update all inputs into the cost of common equity – we cannot be sure that the cost of capital is not distorted, and is realistic.

Second, the cost of equity recommended by Staff in the Ameren³ proceeding is simply not relevant in the instant docket. As in any contested rate proceeding, the order for this proceeding must be based exclusively on the evidence in this record. 220 ILCS 5/10-103, 10-201(e)(iv); BPI I at 227. Moreover, that Dr. Hadaway does not know of any reason why the Commission should adopt a higher cost of equity for the Ameren utilities than for ComEd (ComEd Exhibit 42.0, p. 6) does not mean none exists.⁴ The fact is, the Company failed to demonstrate that the two cases are equivalent. Specifically, Dr. Hadaway's surrebuttal testimony failed to address critical factors that influence Staff's return proposals in the Ameren proceeding. For instance, Dr. Hadaway

³ The issue of the rate of return for the Ameren Companies first arose in the surrebuttal testimony of Dr. Hadaway. He testified regarding a cost of equity of approximately 10.7% for "the Ameren utilities." While ComEd's brief indicates a specific cost of equity of 10.68% for IP and CIPS, those figures do not appear in Dr. Hadaway's surrebuttal testimony.

⁴ The Company emphasizes that Staff used the same methodology in both the instant docket and the Ameren proceeding. The record contains no evidence to support that claim. Nevertheless, it should come as no surprise that the same general methodology can, and often will, produce different results when analyzing the costs of equity for two different companies.

did not identify the relative risk, as exemplified by credit rating or any other metric, of each of the Ameren utilities. Nor did he identify the capital structures that were proposed or the amounts of the common stock flotation cost adjustments, if any, that were included in each of those cost of equity recommendations. Without such data, any evaluation of Staff's return recommendation in this proceeding via comparison to its return recommendations in the Ameren proceeding is useless, since we have no basis on which to assess comparability. Thus, the cost of capital for Ameren is irrelevant to this proceeding.

For all the above reasons, and those set forth in Staff's Initial Brief, the Commission should reject ComEd's proposals of a 10.75% or 10.65% cost of equity.

2. Response to CUB's Initial Brief

In its Initial Brief, CUB recommends a cost of equity 7.77%. CUB IB, p. 30. However, CUB's estimate is based on flawed analyses and should be rejected, as fully explained in Staff' Initial Brief. Staff IB, pp. 58-65. Nevertheless, Staff will address the example on pages 23-24 of CUB's Initial Brief regarding the use of an annual DCF model as opposed to the quarterly model Staff employed.

In its Initial Brief, Staff explained that the use of a quarterly DCF model is not only appropriate for rate setting purposes, but is necessary for a utility to recover its true cost of capital. Staff IB, pp. 58-59. However, CUB's Initial Brief provides an example that purportedly demonstrates that the quarterly DCF "double-counts" the effect of quarterly growth and compounding. To the contrary, that example shows precisely how CUB witness Thomas's use of an annual DCF model ignores the market indicated investor required return and, instead, under compensates the Company as the result of the false

assumption of annual dividends. The scenario set in the first bullet point ignores the time value of money, incorrectly assuming that the cost to a company of paying a quarterly dividend is the same as if an annual dividend were paid. CUB IB, p. 23. The second scenario reflects the true investor required return, given the reality that utilities actually pay dividends quarterly. Id., pp. 23-24. By ignoring the time value of money, the first scenario understates the cost of equity by 14.61%.⁵ Likewise, Mr. Thomas's use of an annual DCF despite ComEd's payment of quarterly dividends understates the cost of equity. In contrast, the quarterly DCF properly compensates Company for the cost it incurs.

D. Overall Cost of Capital (Derivative)

ComEd's weighted average cost of capital is 8.36%. ICC Staff Exhibit 17.0, Schedule 17.1.

E. Effects of Riders SMP and SEA

ComEd in its Initial Brief states that the only Staff or Intervenor witness who addressed the issue in rebuttal testimony was Staff witness McNally and he opposed any reduction in ComEd's overall rate of return on rate base assets in the event Rider SMP is adopted. ComEd IB, p. 65. While that is true, Mr. McNally also testified that a downward (upward) adjustment to the rate of return on Rider SMP assets would be appropriate for each Rider SMP component the Commission adopts that would reduce

⁵ In fact, if investors expected to be paid only a single \$12 dividend at the end of the year, as the first scenario implies, they would not pay \$10 for a share of that stock at the beginning of the year. Rather, assuming all else is equal between the two scenarios, they would pay only approximately \$8.91, in order to earn their required return of 34.61% ($12 \div 8.91 \approx 1.3461$).

(increase) risk. Staff IB, pp. 66-67. Staff's Initial Brief further explained that Staff was not able to present a specific cost of equity proposal for Rider SMP assets because Staff is not aware of an appropriate means to do so. Id., p. 67.

VII. NEW RIDERS

B. Rider SMP

ComEd continues to seek approval of its proposed Rider SMP. ComEd IB, pp. 66-83. However, ComEd's current proposal reflects changes to certain terms and conditions of Rider SMP that it accepted during the course of this proceeding, and a revised Rider SMP process that will include a 6-month workshop process and a 6-month project review and approval proceeding before approval and implementation of specific projects. While the changes ComEd has incorporated into Rider SMP have generally improved its proposal and eliminated or reduced some of Staff's objections to approval of Rider SMP, all issues were not resolved and Staff remains opposed to approval of Rider SMP at this time.

While the bases for Staff's opposition to Rider SMP will necessarily take the form of adversarial positions in this contested proceeding, Staff's opposition is primarily driven by the fact that ComEd seeks approval of a cost recovery mechanism for an undertaking (i.e., implementation of smart grid technology) that has not yet been adequately defined or established in terms of details, scope or duration. In other words, the most appropriate process to reach the best decisions about grid modernization should first determine what needs to be done, and then determine whether and to what

degree it is necessary to approve a particular non-traditional, cost recovery mechanism – i.e., a rider. Tr. 154:1-5.

Putting aside the issue of whether to approve a cost recovery mechanism at this time, there appears to be widespread support for a process to explore the issue of grid modernization. Staff's position is that the issue of grid modernization is simply too large and too complex to entrust its study and analysis to a process with a timeline that is rigidly constrained by a calendar. Tr. 154:5-11. While ComEd and certain parties advocate or support a fixed 6-month timeline, it is Staff's view that the timeline for such an investigation should be driven by the information that is developed in the course of the investigation and that 9-months is a more appropriate estimated timeframe. Further, the parties -- or any one party -- should be able to request that the Commission extend any timeline so as to preserve the ability to avoid the premature termination of the process due merely to the passage of time (i.e., where progress continues to be made in terms of identifying and/or resolving issues).

As set forth in Staff's Initial Brief, Staff has provided an alternative detailed list of conditions and requirements that the Commission should adopt in the event the Commission determines that rider recovery of system modernization projects is appropriate. Staff continues to support those alternative conditions and requirements.

1. ComEd's Support for Rider SMP

ComEd's support for Rider SMP is essentially a two part argument asserting that system modernization projects not necessary to meet minimum service obligations can produce benefits for ratepayers and that without a rider recovery mechanism those projects will not or can not be undertaken and implemented given ComEd's financial

condition and the need for regulatory certainty regarding the prudence of undertaking those investments before they are made. ComEd IB, pp. .66-67. While Staff acknowledges that there may be benefits to system modernization, ComEd’s proposal fails to establish sufficient details regarding its implementation of smart grid technology to make that finding at this time. Moreover, even assuming for the sake of argument that such benefits would result from certain system modernization projects, given the broad definition of costs and projects eligible for recovery under Rider SMP it is impossible to find at this time that Rider SMP will be limited to costs that achieve such benefits.

The failure of Rider SMP to narrowly define the costs that can be recovered there under appears to be a fatal flaw at this time, and is not saved by the provision for Commission approval of specific projects in advance. See ComEd IB, pp. 69, 72. In *City of Chicago v. Illinois Commerce Comm’n*, 13 Ill. 2d 607, 608-609, 614 (1958) (“City I”) – in an appeal from a Commission order approving a rider for Peoples Gas “providing for an automatic adjustment from time to time of its sales price for gas, to reflect changes in the wholesale cost to Peoples of natural gas purchased” -- the Illinois supreme court determined, in a case of first impression, that the Commission was authorized under the Public Utilities Act to approve an automatic adjustment clause in a proper case. The court first considered whether the approval of an automatic adjustment clause exceeded the Commission’s statutory power by contravening the requirements in Section 36 of the Public Utilities Act⁶ regarding the method and

⁶ The court identified the relevant statutory language as follows:

The governing statutory provisions are contained in section 36 of the Public
(continued...)

procedures for changes in rates. (*Id.* at 609-612) Focusing on the broad common and statutory definitions of “rate”⁷, the court found that the Commission’s authority to approve changes in rates included the power to approve provisions that affect the dollar-and-cents cost of the product sold and was not limited to approving rates stated in terms of dollars and cents. (*Id.* at 611-12) As explained by the court:

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. The present automatic adjustment clause is a set formula by which the price of natural gas to the ultimate consumer is fixed by inserting in the formula the wholesale price of natural gas as established by the FPC. The Public Utilities Act, taken as a whole, contemplates that a rate schedule may contain provisions which will affect the dollar-and-cents cost of the product sold.

(continued from previous page)

Utilities Act, (Ill. Rev. Stat. 1957, chap. 111 2/3, par. 36,) which provides the method for any change "in any rate or other charge or classification, or in any rule, regulation, practice or contract relating to or affecting any rate or other charge, classification or service, * * *." The section requires that the utility must file its proposed new schedule with the Commission 30 days before the schedule is to be effective. After the schedule is filed, the Commission shall have the power "either upon complaint or upon its own initiative without complaint, at once, * * * to enter upon a hearing concerning the propriety of such rate or other charge, classification, contract, practice, rule or regulation, and pending the hearing and decision thereon, such rate or other charge, * * * shall not go into effect. * * * All such other rates or other charges, * * * not so suspended shall, on the expiration of thirty days from the time of filing the same with the Commission, or of such lesser time as the Commission may grant, go into effect and be the established and effective rates or other charges, * * * subject to the power of the Commission, after a hearing had on its own motion or upon complaint, as herein provided, to alter or modify the same."

(*City of Chicago*, 13 Ill. 2d at 610). This language was readopted by the legislature in substantially the same form in subsequent enactments, and is currently found in Section 9-201 of the Act. (See 220 ILCS 5/9-201)

⁷ The statutory definition of “rate” has not changed since *City of Chicago* and is currently found in Section 3-116 of the PUA. (220 ILCS 5/3-116 (“‘Rate’ includes every individual or joint rate, fare, toll, charge, rental or other compensation of any public utility or any two or more such individual or joint rates, fares, tolls, charges, rental or other compensation of any public utility or any schedule or tariff thereof, and any rule, regulation, charge, practice or contract relating thereto.”))

(*Id.* at 611)

The court also considered the rationale and holding in *City of Norfolk v. Virginia Electric & Power Co.*, 197 Va. 503, 90 S.E. 2d 140 (1955), because the court there considered similar arguments with respect to virtually identical statutory language. (*Id.* at 612-613) In *Norfolk* the court found that the Virginia Commission was statutorily authorized to approve schedules that affect the rates charged and reasoned that the resulting rates under a formula based adjustment clause “are as firmly fixed as if they were stated in terms of money.” (*Id.* at 613) As to the contention that an automatic adjustment clause violates the statutory requirement for notice of each increase in the actual rate, the court in *Norfolk* reviewed the relevant statutory language and concluded that “notice is not required on each occasion when there is a change in ratepayers bills but that notice is required for every change in the filed schedules which are the underlying basis for the computation of these bills.” (*Id.* at 613) Similarly, the court in *Norfolk* found that due process was not denied since notice of each change in the filed schedules provides an opportunity to be heard as to the justness and reasonableness of the rates charged. (*Id.* at 613-614) The Illinois Supreme Court found the logic expressed in *Norfolk* to be sound and compelling, and concluded that the Illinois PUA vested “the Commission with power to authorize an automatic adjustment clause to be filed in a rate schedule in the proper case.” (*Id.* at 614). The court also rejected a claim that the automatic adjustment clause improperly shifted the burden of proof from the utility to consumers because the Commission retained the right to initiate proceedings to investigate any schedule of rates and the burden of proof would be upon the utility in such proceedings. (*Id.* at 616-618)

As noted above, *City I* held that “notice is not required on each occasion when there is a change in ratepayers bills but that notice is required for every change in the filed schedules which are the underlying basis for the computation of these bills.” *Id.* at 613-614. The failure of Rider SMP to specifically define the costs eligible for recovery under Rider SMP contravenes this requirement. Under Rider SMP those costs will only be defined when a project is specifically approved by the Commission, and that proceeding is a special Rider SMP proceeding rather than an Article 9 proceeding with notice to rate payers. While Staff does not oppose the approval feature of Rider SMP, that feature does not remedy the failure of Rider SMP to provide adequately specify the costs eligible for recovery under Rider SMP. As indicated in Staff’s Initial Brief, pp. 76-78.

With respect to ComEd’s assertion that a rider mechanism is the only way to achieve regulatory certainty as to the prudence of undertaking such investments before they are made, ComEd is in error. ComEd IB, pp. 67, 70, 72. Section 8-503 of the PUA specifically empowers the Commission to authorize additions, extensions, repairs or improvements to utility plant if certain findings are made. Section 8-503 provides, in relevant part, as follows:

Whenever the Commission, after a hearing, shall find that additions, extensions, repairs or improvements to, or changes in, the existing plant, equipment, apparatus, facilities or other physical property of any public utility or of any 2 or more public utilities are necessary and ought reasonably to be made or that a new structure or structures is or are necessary and should be erected, **to promote the security or convenience of its employees or the public or promote the development of an effectively competitive electricity market, or in any other way to secure adequate service or facilities**, the Commission shall make and serve an order authorizing or directing that such additions, extensions, repairs, improvements or changes be made, or such structure or structures be erected at the location, in the manner

and within the time specified in said order; provided, however, that the Commission shall have no authority to order the construction, addition or extension of any electric generating plant unless the public utility requests a certificate for the construction of the plant pursuant to Section 8-406 and in conjunction with such request also requests the entry of an order under this Section. ...

220 ILCS 5/8-503 (emphasis added). While this particular statutory mechanism has been seldom used, it clearly exists and ComEd cannot contend that a rider is the only means of obtaining the regulatory certainty it desires. Staff also notes that Section 8-503 allows the Commission to direct a utility to undertake certain investment. Rider SMP, by limiting itself to projects proposed by ComEd, conflicts with this statutory power. If the event the Commission decides to approve Rider SMP, it should clearly indicate that Rider SMP does not limit in any way, including in Rider SMP approval proceedings, its authority to direct ComEd to undertake certain investments under Section 8-503.

2. Scheduling Issues

As noted above, Staff's position is that the issue of grid modernization is simply too large and too complex to entrust its study and analysis to a process with a timeline that is rigidly constrained by a calendar. ComEd's Initial Brief contains a Biennial Review Schedule based on a 6-month workshop process and a 6-month approval proceeding. ComEd IB, p. 74. Staff proposed a 9-month workshop process that may be extended if appropriate, and submits the following schedule that could be followed if the workshop is completed within nine months:

Staff Illustrative Biennial Review Schedule	
September 14, 2008	Deadline for Commission Order
October 2008	First Workshop Process Start
July 1, 2009	First Workshop Process Ends
August 1, 2009	First Biennial Review Filing by ComEd Due
January 31, 2010	Commission Order in First Biennial Review Case
April 1, 2010	SMP Deployment Begins Per First Biennial Review Case Order
February 15, 2011	SMP Deployment Analysis Report Due to Stakeholders
March 1, 2011	Second Workshop Process Start-Up
June 1, 2011	Second Workshop Process Ends
August 1, 2011	Second Biennial Review Filing by ComEd Due
January 31, 2012	Commission Order in Second Biennial Review Case
April 1, 2012	SMP Deployment Begins Per Second Biennial Case Order

The foregoing illustrative schedule would be adjusted if and to the extent the First Workshop Process lasts for any time period other than 9-months.

3. Establishing Investment Is Prudently Incurred and Used and Useful

ComEd’s Initial Brief, in the context of discussing the reconciliation process included in proposed Rider SMP, refers to Staff witness Linkenback’s concerns regarding Rider SMP’s impact on, relationship to, and compliance with the requirement under Section 9-211 of the PUA that “in **any determination of rates or charges**, [the Commission] shall include in a utility’s rate base **only the value of such investment which is both prudently incurred and used and useful** in providing service to public utility customers.” ComEd IB, p. 80; 220 ILCS 5/9-211 (emphasis added). ComEd’s

discussion of these concerns in the context of the reconciliation process misses Staff's point, and reflects a misunderstanding or misapprehension of Staff's concerns.

ComEd argues that "Staff's concern that this proceeding 'is the only opportunity the Commission will have to fulfill its Section 9-211 responsibility to make a prudence determination' is misplaced. Linkenback Dir., Staff Ex. 12.0, 8:178-88." ComEd IB, p. 80 (Emphasis added). Mr. Linkenback's concern was valid when made and remains valid today, and was directed when made to the approval of specific Rider SMP Projects in this rate case. Mr. Linkenback's concern regarding a determination of prudence under Section 9-211 was not directed to the reconciliation process, as indicated in ComEd's Initial Brief. Rather, as indicated in the cited portion of Mr. Linkenback's testimony, he was addressing ComEd's requests in the instant docket (which requests were subsequently dropped, but may be included in proposed Rider SMP's biennial project review/approval proceedings) for approval of specific SMP Projects, and its statements in data request responses indicating that approval of specific projects under Rider SMP would constitute a binding determination with respect to the prudence of undertaking those projects. ICC Staff Exhibit 12.0, 8:178-88. In other words, the issue raised does not concern the reconciliation process, but instead addresses what review process the Commission should use to determine the prudence of the specific Rider SMP Projects proposed for approval.

Staff witness Linkenback was also expressing his opinion that the standard for such a prudence finding for the proposed SMP projects should be based upon standards similar to those in Section 9-212 of the Act, which he explained is the same standard the Commission uses when evaluating capital additions to rate base in a rate

case proceeding, and the fact that ComEd had not provided sufficient information to demonstrate that the projects were prudent. ICC Staff Exhibit 12.0, p. 8. Staff witness Ms. Hathhorn also agreed to a six, rather than nine month, approval period for SMP projects based upon the requirement that all ComEd filings for approval of SMP projects include evidence, at the time of filing, to determine the SMP projects' prudence. ICC Staff Exhibit 14.0, pp. 21-22 ComEd stated "[i]t was always ComEd's intention to address such [prudence] issues in pre-filed testimony that would be included with its petition initiating the annual approval proceedings under Rider SMP; therefore, ComEd does not object to the provision of such information." ComEd Ex. 43, p. 21. However, the evidence from this case shows that ComEd's interpretation of the evidence required to determine a project's prudence is debatable at best. The issue raised in Mr. Linkenback's testimony, i.e. application of the prudence standard of Section 9-212, is not addressed by ComEd in its Initial Brief. Should the Commission decide to approve Rider SMP, Staff recommends that the Commission endorse the standards set forth in Section 9-212 of the PUA with regard to Rider SMP projects. Staff also notes that to date ComEd has not provided sufficient information to show why any of the SMP projects which it no longer is seeking approval of are prudent or used and useful. See ICC Staff Ex.19.0, 13-18.

4. Comments On Intervenor Positions

A number of Intervenors, including the AG, also oppose approval of Rider SMP. In general, Staff agrees with the technical and factual criticisms by these parties regarding ComEd's support for approval of Rider SMP. However, Staff did not make certain legal arguments regarding Rider SMP that various Intervenors raised in their

initial briefs regarding single-issue ratemaking, retroactive rate making, and test year rules. While Staff believes the Commission should exercise its discretionary authority to reject Rider SMP at this time, Staff finds that ComEd's agreement to incorporate various consumer protections into its proposed Rider SMP presents circumstances under which the Commission may have the discretion to approve Rider SMP notwithstanding the prohibitions against single-issue and retroactive ratemaking and the Commission's test year rules.

a. Single-Issue Ratemaking

The AG and others assert that Rider SMP would violate the prohibition against single-issue ratemaking. See e.g., AG IB, pp. 29-32. While Staff's generally agrees with the AG's summary of the prohibition against single-issue ratemaking, Staff does not fully agree with her discussion of the application of that doctrine in connection with riders. Specifically, the AG suggests that 'Given the fact that this docket is a general rate case, the *Citizens Utilities Board [v. Illinois Commerce Comm'n]*, 166 Ill. 2d 111 (1995)] holding demands consideration of the single-issue ratemaking argument. AG IB, p. 30. The AG appears to argue that because ComEd's proposed Rider SMP is being presented in connection with a general rate case, the prohibition against single-issue ratemaking applies (but would presumably not apply if ComEd had separately filed Rider SMP). While *Citizens Utilities Board* does discuss the application of the prohibition against single-issue ratemaking in the context of a general rate case, it misreads this statement to view the rule against single-issue ratemaking as varying depending on whether a rider request is presented on a stand alone basis or in combination with a general rate case. This statement is more appropriately interpreted

as holding that exceptions to the prohibition against single issue ratemaking are recognized in connection with a rider proposal, but are not recognized in connection with a general rate increase request.

So as to provide relevant background for this discussion, Staff will first review the court's opinion in *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317 (1st Dist. 1993), where the court considered various challenges to a Commission order allowing Commonwealth Edison Company ("Edison") to recover costs associated with demand-side management ("DSM") programs through a rider designated as Rider 22. The court explained that a rider "is a form of tariff that modifies an otherwise applicable standard rate under specific circumstances." (*Id.* at 321-322) IIEC and CUB argued on appeal that Rider 22 violated the prohibition against single-issue ratemaking. (*Id.* at 324) The court reviewed the basis and rationale for the prohibition against single-issue ratemaking, and found that the Commission's approval of Rider 22 violated that prohibition:

In determining the amount of money a utility is authorized to collect from the consumers, the Commission is required to consider all aspects of the utility's operations during a year selected by the utility as a test year. The test year so selected is intended to be representative of both the utility's anticipated rate-base expenses and its expected revenues, including overall costs and rate of return in the same year. Here, instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, single-issue ratemaking considers those changes in isolation, ignoring the totality of circumstances. ...

In the present case, the Commission authorized Edison to charge customers for DSM program costs without considering whether other factors offset the need for additional charges. The order violates the prohibition against single-issue ratemaking. The order thereby isolates one operating expense for full recovery without considering whether changes in other expenses or increased sales and income obviate the need for increased charges to consumers, which may result impermissibly

in ratepayers facing additional charges for direct and indirect additional revenues to cover Edison's expenses and pay a return to its investors.

(*Id.* at 325-326)

The court also disagreed with the Commission's argument that applying the prohibition against single-issue ratemaking outside of a general rate case would unduly restrict the Commission and utilities. (*Id.* at 326-327) The court recognized that "[r]iders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses," but found that the DSM related expenses at issue were ordinary expenses such as: "payroll for specifically identified planning and similar positions; personnel training, education and travel; contractors and consultants costs; out-of-pocket promotion and computer costs; and conducting workshops." (*Id.*) The court found that the DSM costs at issue "reveal no greater potential for unexpected, volatile or fluctuating expenses which Edison cannot control, than costs incurred in estimating base ratemaking." (*Id.*) Additionally, the court found that a delay in the recovery process and the failure to include such costs in Edison's last rate case did not justify single-issue treatment of costs in a rider. (*Id.*)

Single-issue ratemaking in the context of a rider was next considered in *Central Ill. Light Co. v. Illinois Commerce Comm'n*, 255 Ill. App. 3d 876 (3rd Dist. 1993) ("*CILCO v. ICC*"), affirmed in part and reversed in part, *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111 (1995) ("*CUB v. ICC*"), where the Third District Appellate Court and Illinois Supreme Court both upheld the Commission's approval of a rider to recover coal tar clean-up expenditures for costs associated with cleaning up environmental damage resulting from former manufactured gas plant ("MGP") operations. The Office of Public Counsel ("OPC") and CUB contended that the Commission lacked statutory

authority to approve rider recovery of coal tar clean-up costs, and further asserted that rider recovery violates the prohibitions against single-issue and retroactive ratemaking as well as the Commission's test year rules. (*CILCO v. ICC*, 255 Ill. App. 3d at 883) The court observed that the Commission's authority to approve riders in appropriate situations was recognized by the Illinois Supreme Court in *City I*. (*Id.* at 884) Declining to "read the *Finkl* opinion in the broad terms asserted by OPC/CUB," the court in *CILCO* also rejected the argument that riders *per se* violate the prohibitions against single-issue and retroactive ratemaking as well as the Commission's test year rules:

In *Finkl*, the First District reversed an order of the Commission which had allowed Commonwealth Edison to utilize a rider to recover costs associated with demand-side management programs. Although the court found the rider in that case to violate both the prohibition against single-issue and retroactive ratemaking, and to contravene the Commission's "test year" requirements, **we do not interpret the opinion as holding that all riders are prohibited**. We note the opinion states with apparent approval that riders are useful in alleviating the burden imposed on utilities in meeting unexpected, volatile or fluctuating expenses. However, in the case before the court, the First District found the demand-side management expenses were not of such a nature as to require rider treatment, and could be readily addressed through traditional base rate proceedings.

Therefore, we read *Finkl* as holding that the Commission abused its discretion in allowing a rider recovery mechanism under the circumstances because demand-side management costs are not of an unexpected, volatile or fluctuating nature so as to necessitate recovery through a rider. Again, we do not read *Finkl* as holding that the Commission does not have the authority to allow recovery of costs through riders. Given our view of the *Finkl* court's holding, we view the opinion's discussion of retroactive ratemaking and test year rules as dicta.

In the instant case, we find no abuse of discretion on the part of the Commission in concluding that coal tar remediation costs can be recovered through a rider mechanism. The record shows these costs will vary widely from year to year depending on the type of remediation activities: from relatively small sums in the thousands (investigation costs) to the millions of dollars (actual cleanup costs). **We view these costs as the type of unexpected, volatile and fluctuating costs which are more efficiently addressed through a rider mechanism**. Therefore, we find

the Commission had the authority to authorize a rider as the preferred method of recovery, and that under the circumstances such authorization did not constitute an abuse of discretion.

(*Id.* at 884-885 (emphasis added))

In the subsequent appeal to the Illinois Supreme Court, the court found that CUB waived its retroactive ratemaking and statutory authority arguments by failing to raise them in its petition for rehearing. (*CUB v. ICC*, 166 Ill. 2d at 136) The Supreme Court then proceeded to address CUB's contentions that the Commission's approval of rider recovery of coal tar clean-up costs constituted impermissible single-issue ratemaking and violated the Commission's test year rules, and rejected both arguments. (*Id.* at 136-140) The Supreme Court found that although the prohibition against single-issue ratemaking applies *per se* in the context of developing a utility's revenue requirement in a base rate proceeding, it does not prohibit the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant:

In the present case, we are not faced with the Commission's treating a single-expense item **within the context of a general rate case**. In contrast, a rider mechanism merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return. The prohibition against single-issue ratemaking requires that, in a general base rate proceeding, the Commission must examine all elements of the revenue requirement formula to determine the interaction and overall impact any change will have on the utility's revenue requirement, including its return on investment. **The rule does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment.**

(*Id.* at 137-138 (emphasis added)) In other words, the court held that an exception to the prohibition against single-issue ratemaking may be recognized outside the context of developing a revenue requirement in a base rate proceeding so as to permit rider recovery of unique costs when circumstances warrant.

The court then considered whether circumstances warranted rider recovery of coal tar clean-up costs, and found that there was no violation of the prohibition against single-issue ratemaking (i.e., an exception was warranted) given the uncertain and variable nature of the expenses for coal-tar clean up:

In *City of Chicago v. Illinois Commerce Comm'n* (1958), 13 Ill. 2d 607, 610-11, 150 N.E.2d 776, this court highlighted **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**. * * * This court noted that a **rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses**. In the generic coal-tar order at issue in this appeal, the Commission stated that, given the wide variations and the difficulties in forecasting the costs of investigation and remediation activities, riders can generally be expected to provide a more accurate and efficient means of tracking costs and matching such costs with recoveries than would base rate recovery methods. **Numerous witnesses testified to the uncertain and variable nature of the expenses for coal-tar clean up**. We find that the proposed recovery through a rider mechanism, outside the context of a traditional rate proceeding, does not violate the prohibition against single-issue ratemaking.

(*Id.* at 138-139 (emphasis added))

Single-issue ratemaking was again considered in *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill. App. 3d 617 (1st Dist. 1996) ("City II"), where the City of Chicago ("City") appealed a Commission order directing Commonwealth Edison Company ("ComEd") to remove local franchise fees from base rates for all customers and to localize recovery of those costs by a separate line item charge on the bills of customers residing in the municipality charging the fee. Base rate recovery of franchise fees was resulting in customers outside the City of Chicago paying significantly more -- a net difference of approximately \$34 million in 1991 and \$33 million in 1992 -- for franchise payments to the City of Chicago than customers within the City of Chicago were paying for franchise fees (in the form of free service) to municipalities outside of

the City. (*Id.* at 620) The Commission’s decision to remove franchise fees from base rates for rider recovery was intended “to remedy the unreasonable recovery of franchise fees and free and reduced service imposed on Edison by local governmental units” (*Id.* at 622)

The City argued that the use of a rider for recovering franchise costs violated the prohibition against single-issue ratemaking. (*Id.* at 627) The court noted that “[t]he **Commission has the power to authorize riders in a proper case** and such authorization will not be reversed absent an abuse of discretion.” (*Id.*) The court also explained that “[s]ingle-issue ratemaking is prohibited because it considers changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement.” (*Id.*)

The court first rejected the City’s argument that, pursuant to the court’s decision in *Finkl*, “only unexpected, volatile or fluctuating expenses are properly recovered through a rider:

A. Finkl . . . 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 (sic)*, 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) The court also observed that while the Supreme Court’s decision in *CUB v. ICC* found that the a rider was appropriate for fluctuating costs, “it did not limit the use of a rider only to those instances where costs are unexpected, volatile or fluctuating.” (*Id.*) Thus, the court found that the Commission’s reliance on the unfairness of disparate cost recovery among customers in different localities -- rather than on identification of an

unexpected, volatile and fluctuating expense -- as justification for allowing rider recovery of franchise fees was not improper.

While acknowledging that "Riders are closely scrutinized because of the danger of single-issue ratemaking," the court concluded that the danger of ignoring some items that might have an impact on the overall revenue requirement did not exist under the facts of this case:

Here, however, that danger was not present. The proposed restructuring was exactly that--a reallocation which did not have any impact whatsoever on Edison's overall revenue requirement. The franchise fees were already included in Edison's overall rate structure; the Commission's order simply redistributed them. Because the rider here "merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return" (*Citizens Utility Board*, 166 Ill. 2d at 138, 651 N.E.2d at 1102), it was not an abuse of discretion for the Commission to use it as the mechanism of cost recovery.

(*Id.* at 628-629)

The opinions in Finkl, *CILCO v. ICC*, *CUB v. ICC*, and *City II* establish that – in contrast to the *per se* application of the prohibition against single-issue ratemaking in a rate case context – exceptions may be recognized on a case by case basis in the context of determining whether rider recovery is warranted. While the courts have not set down firm rules for determining the scope of exceptions which may be recognized, it is clear that a balancing test is applied including the benefits of or justification for rider recovery on the one hand and the presence or extent of the evil or problem that the prohibition against single-issue ratemaking attempts to remedy on the other.

In the instant case, the nature of Rider SMP clearly presents some risk that rates could increase for SMP investments at the same time that savings, cost reductions or revenue increases are achieved. However, ComEd has agreed to an earnings test that significantly tempers this risk by requiring ComEd to forego recovery under Rider SMP if

and to the extent its actual earnings exceed its last authorized rate of return. In this manner, Rider SMP indirectly takes into account savings, cost reductions and income changes. In Staff's view, an earnings test can sufficiently address the risk of the harm to ratepayers that the prohibition against single issue ratemaking is intended to remedy, and for that reason Staff does not assert a single-issue ratemaking argument. That is, were the Commission to find that adequate justification existed for Rider SMP, the prohibition against single-issue ratemaking would not divest the Commission of discretion to approve Rider SMP given the earnings test provision incorporated into Rider SMP. Staff wants to be clear, however, that the presence of an earnings test would not automatically call for an exception. Rather, the facts of each case need to be examined and analyzed. For the foregoing reasons, Staff does not agree with the assertions by the AG and others regarding single-issue ratemaking. See e.g., AG IB, pp. 45-48, 58-60.

b. Retroactive Ratemaking and Test Year Rules

Similar to the single-issue ratemaking issue, Staff did not assert retroactive ratemaking or test year arguments as did the AG and others. With respect to retroactive ratemaking, Staff's view is that Rider SMP does not operate so as to adjust a rate which was previously approved by the Commission. For this reason, Staff does not believe retroactive ratemaking is an issue. With respect to the test year rules, Staff would note that the goal or purpose of those rules is very similar to the goal or purpose of the prohibition against single-issue ratemaking: to ensure that all costs and revenues are considered together over a uniform period. Where courts have found adequate justification for adoption of a rider, they have not found a violation of the Commission's

test year rules. For the same reason that Staff does not assert a single-issue ratemaking argument, Staff does not assert a test year rule violation argument.

C. Rider SEA

Rider SEA (Storm Expense Adjustment) provides for recovery of operating and maintenance (“O&M”) expenses related to storm restoration through a combination of base rates and a rider-based tracking mechanism. “[T]he Storm Adjustment, which may be a charge or a credit, will reflect the difference between (1) a specified baseline amount for O&M expenses related to storm restoration and (2) such actual expenses incurred during the previous calendar year. In other words, the rider tracks the difference between the base amount and actual costs on an annual basis.” ComEd Ex. 11.0 Corrected, 13:238-244.

The main issue with respect to this proposal is whether the Company has established that special rider recovery of this O&M expense is warranted. In order for an O&M expense to warrant special rider treatment, it must generally be shown that the utility is faced with an expense that is substantial, volatile, or fluctuating. *Citizens Util. Bd. v. Illinois Commerce Comm’n*, 166 Ill. 2d 111, 138-139 (1995). As explained in Staff’s Initial Brief, the record does not support the assertion that storm costs are sufficiently volatile, fluctuating, or unpredictable to justify rider recovery. Staff IB, pp. 82-87. The Company claims that the purpose of Rider SEA is to avoid detracting from ComEd’s plans to maintain or improve service quality and reliability and to avoid financial harm due to the alleged volatility of such expenses. ComEd IB at 83-84. These

arguments lack merit and do nothing to establish the type of volatility needed to justify rider recovery.

ComEd argues that base rate treatment for these costs can result in either customers overpaying for storm expenses or ComEd not being able to recover its prudently incurred costs in any given year. ComEd IB, p. 84. The Company contends that either scenario presents problems for ratepayers because, even when storm expenses are higher than the base rate amount, the Company must reprioritize its expenditures which detracts from its plans to maintain or improve service reliability. *Id.* For instance, in testimony Mr. Crumrine warns of “...forgone opportunities for investment in the distribution system “ (ComEd Ex., 30.0 at 32:725-726 in the absence of Rider SEA. But, as Staff presented in its testimony and Initial Brief, the Company fails to explain what forgone opportunities for investment in the distribution system might arise. Clearly ratepayers wish to receive reliable service, However, it would be poor policy to approve Rider SEA based on some vague notion of “forgone opportunities” that would be lost. Staff IB at 91;ICC Staff Exhibit 18.0 at 27-28:624-630. Furthermore, ComEd’s argument disregards the fundamental concepts underlying the normalization of certain expenses in base rates. While virtually all expenses are subject to some variability, the general practice is to set rates based on the test year expenses presented by the utility. An exception to this general practice is followed for certain expenses where the test year amount does not represent a normal level of expense. A normalized level of expense is developed, typically through an averaging of the subject expense over a period of time. While the normalized amount recovered in any given year may vary from the actual amount incurred in any given year, the amount recovered

over time will generally equal the actual amount incurred over time. The variability which justifies normalization of certain expenses is not the same as the variability that justifies rider recovery; rather, normalized expenses are recovered through base rates.

1. Traditional Base Rate Recovery of Storm Expenses is Adequate.

Staff has identified a number of deficiencies in ComEd's arguments. As Staff explained in its testimony and its Initial Brief, the year to year variability of ComEd's storm expenses is not significant. ICC Staff Exhibit 14.0 at 20. Therefore, any expenditures ComEd planned to make benefitting ratepayers are not necessarily threatened by years in which storm expenses are not fully recovered. Rather these expenditures are actually encouraged in those years where the Company over-recovers, undercutting the Company's argument that ratepayers would be harmed without Rider SEA. Furthermore, as the AG points out in its Initial Brief, traditional test year regulation permits ComEd to recover its actual storm restoration expenses over future time periods via use of the multi-year averaging approach even though the Company may over-recover in certain years and under-recover in other years (AG Initial Brief at 73); and even in the year of greatest variability (the year 2007, which included the largest known storm in recent ComEd history) the Company's storm expenses were "only about 4.2 percent of total test year O&M expenses, and such volatility is much lower in all other years." AG Initial Brief at 71. ComEd has offered no evidence to the contrary. Thus, the Company's conclusion that traditional base rate recovery of storm expense is problematic is based on unsubstantiated claims that year to year variation is significant and not recoverable under traditional test year regulation.

2. Storm Expenses are not Unexpected, Volatile, or Materially Fluctuating

Essentially, the Company, in its Initial Brief, once more attempts to bolster their contention of volatility by stating that weather is “unpredictable” and that weather related system costs “can vary by tens of millions of dollars from year to year.” ComEd IB at 87-88; ComEd Ex. 11.0 Corrected at 16:298-299. However, as presented by the chart at page 83 of Staff’s Initial Brief, storm restoration expenses fell below the average for four out of the past six years. During the six year period 2002 through 2007, four of the six years were below the \$27.1 million inflation adjusted six year arithmetic average. Also, from 2003 through 2005 the Company’s storm expense only varied from the base amount by \$2.3 million, \$6.5 million and \$7.8 million, respectively. Staff IB at 83-84. Despite the Company’s contention, the evidence demonstrates the Company’s storm restoration costs were not volatile and did not typically vary, as the Company suggests, by tens of millions of dollars from year to year.

In addition to the claim of volatility, the Company again argues in its Initial Brief that storm expenses, “involve very large costs.” ComEd IB at 87-88. As Staff previously stated in its Initial Brief, Mr. Luth found that these costs are not large relative to the overall revenue requirement. He found the difference between the average amount and the low and high amounts over the past six years is \$19,236,000 over the low of \$7,883,000 in the year 2002 and \$27,718,000 under the high of \$54,837,000 in the year 2007. Those differences are 1.1% and 1.55%, respectively, of \$1,689,892,964 in test year revenues at present rates. ICC Staff Exhibit No. 6.0 at 15:262-267. This level of costs is insufficient to justify the regulatory resources needed to administer the proposed Rider SEA.

The Company also compares ComEd's net income to variance in storm expenses from year to year, arguing that "such a variance in expense represents a significant impact." ComEd IB at 84. Such a comparison, however, is not relevant to determining whether Rider SEA should be favored over traditional base rate regulation. Staff has countered that storm restoration expenses are not significant in comparison to total operating expenses. Staff IB, pp. 85-87. To assess whether a particular expense warrants rider recovery, the courts have found that the relevant comparison is to other operating expenses. In *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317 (1st Dist. 1993) the court held that DSM related expenses were ordinary expense not entitled to special rider treatment, and in so holding relied explicitly on the fact that the expenses for which rider recovery was sought "reveal no greater potential for unexpected, volatile or fluctuating expenses which Edison cannot control, than costs incurred in estimating base ratemaking." *Id.* at 326-327. Applied to the instant case, the *Finkl* opinion demonstrates that Staff's comparison of Rider SEA expenses to total operating expenses is the more relevant comparison; and rider recovery is not justified since storm restoration expenses are not significant in comparison to the Company's total operating expenses.

Again, as Staff presented in its Initial Brief, the only fact the Company has demonstrated is that storm costs vary and the Commission has stated that cost variations alone do not justify rider recovery. In a prior rate case involving The Peoples Gas Light and Coke Company and North Shore Gas Company's ("NS/PGL") request for Rider UBA ⁸, the Commission stated, "...variability is a characteristic of virtually every

⁸ Rider UBA was proposed by NS/PGL to recover the gas cost-related portion of their (continued...)

utility cost. Despite the most perspicacious predictions, future events take their own course. Yet virtually all of those costs are still held within the test year process.” NS/PGL; III.C.C. Docket Nos. 07-0241-07-0242/Cons. (Order, February 5, 2008), at 188. Likewise, in this case fluctuations in storm-related expenses, while expected, are insufficient to trigger frequent general rate proceedings if they are recovered under base rates. Staff IB at 86-87.

As IIEC witness Stephens has stated, “Storms and their related expenses are nothing new to utilities. ComEd has operated for decades without a separate storm expense adjustment, relying on traditional ratemaking of those expenses.” IIEC Ex. 1.0-C at 36:754-757. Thus, there is no justification to warrant the drastic departure from traditional ratemaking. At this time, there is no evidence of existing forward looking storm riders or any success or failure related to such riders. Staff IB at 92. However, the issue of a Rider for storm restoration expense was recently reviewed by the Pennsylvania Public Utility Commission in *Pennsylvania Public Utility Comm’n v. Metropolitan Edison Co.*, R—00061366, et al., 2007 Pa. PUC Lexis 5, 270 (Pa. P.U.C. Jan. 11, 2007) (“MEC Order”).⁹ The Office of Trial Staff (“OTS”) opposed the Storm Damage Rider (“SDR”):

The OTS also opposed MEPN's [: Metropolitan Edison Company (“ME”) and Pennsylvania Electric Company (“PE”) collectively (“MEPN”)] SDR noting that riders are traditionally used to allow utilities recovery of volatile expenses. (OTS M.B. at 26). The OTS maintained that storm damage is not sufficiently volatile to necessitate rider treatment because the Companies already recover a normalized level of storm damage expense.

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uncollectables expense -also called bad debt expense- See NS/PGL; III.C.C. Docket Nos. 07-0241-07-0242/Cons. Order at 184.

⁹ Although noteworthy, the Pennsylvania case is not precedent before the Commission.

Id. OTS witness, Mr. Keim, reviewed the five year history of storm damage expenses and concluded that the budgeted claim is sufficient to account for yearly fluctuations. *Id.*

MEIUG/PICA [Complaint Parties] argued that the SDR should be rejected because the Companies have not proven that the ratemaking process under which storm costs are normally collected should be circumvented. MEIUG/PICA M.B. at 66; MEIUG/PICA St. 2 at 15-16). MEIUG/PICA opined that the Companies currently have an adequate means by which to collect storm damage costs via both base rate proceedings and accounting deferrals. (MEIUG/PICA M.B. at 68). costs without adequate Commission review. *Id.*

MEC Order, 2007 Pa. PUC Lexis 5 at 270-271. The MEC Order goes on to state the ALJ's recommendation:, "The ALJ's found that the arguments of...were persuasive and determined that the Companies did not meet their burden of proving that the SDR is in the public interest and should be approved.." *Id.* at 272-273. The PA Commission's disposition stated, "We concur with the ALJs that the companies did not meet their burden of proving that the SDR is in the public interest. *Id.* at 273. Similarly, in this case, storm restoration expenses during the six year period 2002 through 2007, were not sufficiently volatile to justify rider recovery under Rider SEA. Staff IB at 83-84.

3. Other Issues

a. Accounting for Storm Costs

In its Initial Brief, ComEd also seeks to counter the argument of Staff witness Luth, that Rider SEA would create "an incentive to classify or define a cost as eligible for recovery under a rider." ICC Staff Exhibit No. 6.0 at 17:300-301. ComEd claims this concern is unfounded because "[a]ny inappropriate classification of costs as storm expenses would be subject to Commission review in the annual reconciliation proceeding in the immediately following year." ComEd IB at 89. Additionally, in testimony, Mr. Crumrine had dismissed the serious potential or incentive that would

exist under Rider SEA for the Company to inappropriately classify or define a cost as eligible for recovery under the rider. Mr. Crumrine states that any attempt to inappropriately reclassify costs as storm expenses in order to recover them through the rider would be foolish and shortsighted. ComEd Ex. 30.0, at 33-34:752-758.

Regulation should have the objective of providing proper incentives for utilities to operate efficiently and control costs. A rider mechanism that allows dollar for dollar recovery would diminish the incentive to control storm expenses as the Company will recover whatever it spends. Also, Staff's ongoing review of ComEd's reliability performance may not be sufficient to offset the attractiveness of inappropriate incentives. As Staff witness Mr. Linkenback states, "Staff's review of the utilities' reliability performance are reported to the utilities and the Commission. In my opinion, these reports in and of themselves are not sufficient to totally eliminate or offset the unacceptable financial incentives presented by Rider SEA to reduce ComEd's normal O&M expenditures." ICC Staff Exhibit No. 8.0 at 9:177-180. Furthermore, storm repairs are not all black and white issues, some are gray. Mr. Crumrine himself stated, "...it is possible that a storm might cause some repair work that was already scheduled for some point in the future, such as the replacement of a broken pole that was scheduled to be replaced..." ComEd Ex., 30.0 at 36:805-807. Under Rider SEA, ComEd would have the clear incentive to classify these expenses as storm-related to pass them on to ratepayers in monthly bills. The Commission must protect ratepayers from exposure to this financial risk.

b. Definition of Storm

As stated in Staff's Initial Brief, if the Commission determines it is appropriate for the Company to recover the O&M expenses related to storm restoration through a rider, Staff recommends certain changes to the Rider SEA exhibit (ComEd Ex.,30.2) more specifically set forth in Staff's Initial Brief. Staff IB at 92-95.

The Company repeatedly states that its "suggested definition [of a storm] invokes the rider exactly when needed: when, due to an act of nature, ComEd determines that it must open the storm center and it is anticipated that 10,000 or more customers will lose power for three or more hours. ComEd IB at 89. However, Staff's recommended definition of when a storm occurs utilizes language designated by the National Oceanic Atmospheric Administration's ("NOAA") National Weather Service or for an earthquake designated by the U.S. Department of Interior - US Geological Survey ("USGS"), an objective, independent, and traceable source. Staff IB at 93. In essence, the NOAA and USGS definitions avoid ambiguity or potential bias by using a verifiable definition from an outside source. In addition, the AG notes some of the ambiguities in ComEd's definition that have the potential for strained interpretation. For example the AG states, "Rider SEA contains a plethora of ambiguous and vague language that renders it defective." See AG Initial Brief at 69. The AG goes on to describe some of the inconsistencies inherent in the Company's storm definition, "For instance, rain, drizzle, hot weather or snow flurries could be considered storms and trigger Rider SEA recovery." *Id* at 70.

c. System Maintenance

The Company stated they are, "...subject to potentially significant economic consequences for failure to properly maintain the electric delivery system..." ComEd IB at 90. In addition, the Company references Sections 16-125(e) and (f) of the PUA as evidence that there exists potentially significant economic consequences for failing to properly maintain its distribution system. *Id.*

However, ComEd's verified petitions in Docket Nos. 07-0491 and 08-0044 request that the Commission enter an Order determining that Section 16-125(e) of the Act (220 ILCS 5/16-125(e)) is not applicable to interruptions resulting from the storms referenced therein based on ComEd's assertion that the interruptions that resulted should be viewed as thousands of separate interruptions that all fall under the threshold of 30,000 customers interrupted for four hours or more contained in Section 16-125(e). ICC Staff Exhibit No. 19.0 at 4:104-5:123. As Staff described in its Initial Brief, it appears that ComEd's interpretation of Sections 16-125(e) and (f) of the PUA would hardly provide much economic incentive to properly maintain their distribution system. Staff IB at 90-91.

Also, ComEd still maintains that preventative maintenance is not aimed at protecting the electrical system from storm damage. ComEd IB at 90. However, Staff disagrees with that argument. Staff Witness Mr. Linkenback stated:

I disagree with Mr. Williams' opinion. It is true that planned maintenance cannot prevent all storm related damage to ComEd's distribution system, but it can prevent some storm related damage and will have an effect on the amount of storm related damage repair costs. Some planned maintenance work that can affect the extent or severity of storm damage is testing, maintenance and repair or replacement of circuit breakers, reclosers, protective relay, switches, lightning arrestors, poles and cross arms and their braces on the distribution system.

ICC Staff Exhibit No. 19.0 at 7:150-157.

For all the foregoing reasons, the Commission should reject proposed Rider SEA.

VIII. COST OF SERVICE AND ALLOCATION ISSUES

E. Interclass Allocation Issues

1. Across-the-board increase

ComEd begins its discussion of the issue by noting that a number of parties including Staff support an across-the-board increase on existing rate charges. ComEd IB, p. 99. ComEd responds to these proposals by arguing that “[a] system average increase, however, does not reflect the costs customers impose on the system.” *Id.*

In ComEd’s estimation, the acceptance of an across-the-board allocation proposal would create new subsidies that do not currently exist by shifting millions of dollars from the residential class to the nonresidential class. *Id.* The Company contends an across-the-board approach would continue to exacerbate existing subsidies and make cost-based rate setting in future proceedings even more difficult and adversarial. *Id.*, pp. 99-100. In contrast, ComEd argues its revised rate design proposal is consistent with the Commission’s long-standing goal of moving rates toward costs while addressing bill impacts concerns by gradually moving the largest nonresidential customers to cost-based rates. *Id.*, p. 100.

The Company’s argument would be reasonable if not for the unique and difficult circumstances surrounding this rate case. Ratepayers have absorbed numerous rate increases since the expiration of the statutory rate freeze as of January 2, 2007; and, as

a result, bill impacts have emerged as the over-riding issue for electric ratemaking in Illinois. Staff presented in its Initial Brief a description of the rate increases ratepayers have experienced in the recent past and will likely experience in the near future. Staff IB, pp. 97-98. Staff also identified the extraordinary steps taken by both the Commission and the Legislature to address these increases. *Id.* The importance of the bill impacts issue is evident.

The most reasonable method of designing rates to address these bill impacts would increase existing rates on an equal percentage, across-the-board basis. By increasing all rates on an across-the-board basis, equal recognition is given to all ComEd ratepayers of the difficulties bill impacts present. An alternative approach that distributes these increases unequally may create feelings of unfairness among ratepayers who receive above-average increases. ICC Staff Ex. 18.0, 20:464-21:471.

In the current situation, it is not evident that any one group of customers can more easily absorb increases in delivery services costs than other customers. There is no evidence on the record to show that residential or business customers are more able to absorb disproportionate increases in these costs than the other. Thus, the fairest approach which recognizes the difficulty faced by all is to give all customers the same percentage increase. This approach recognizes that all ratepayers are in a difficult position without attempting the impossible task of determining which customer classes can afford a bigger increase than other classes.

If the Commission determines that some movement towards cost-based rates is appropriate in this proceeding, then it should consider the proposal Staff made in direct testimony to reduce ComEd's proposed increase to Extra Large Load, and High Voltage

(Other) customers. See Staff IB, pp. 101-102. That proposal entails averaging the Distribution Facilities Charge for Medium Load, Large Load, Very Large Load, Extra Large Load, and High Voltage (Other) customers so that each customer class would pay the same \$5.85 DFC per kW of demand. This process would result in Medium Load and Very Large Load customers paying rates that are 2.48 percent and 1.41 percent above ComEd's proposed cost of service, respectively, but would also reduce the proposed increase to High Voltage (Other) customers by 18.11 percent. Averaging ComEd's proposed DFC for Medium Load, Large Load, Very Large Load, Extra Large Load, and High Voltage (Other) customers would also temper ComEd's proposed 140.4 percent increase in revenues from Extra Large Load customers by 2.72 percent. ICC Staff Ex. 6.0, 9:136-149.

F. Supply vs. Delivery Services Allocation Issues

After reviewing the positions and arguments of parties in their initial briefs regarding the issue of allocating costs associated with billing, customer support, and credit and collections ("Customer Care Costs"), Staff acknowledges that some portion of Customer Care Costs might be conceptually proper to allocate to the supply function because it appears intuitive that ComEd's role as a supplier of energy in addition to providing the delivery function would have some impact on the level of these costs. Because the degree of such a potential impact would be very difficult to discern at this point and because Staff did not address this issue in testimony, Staff can offer no specific estimate for a potential allocation at this time. Staff further notes that the issue

of supply-related costs generally was addressed in Docket Nos. 07-0528/07-0531, Commonwealth Edison's procurement plan and related tariffs.

XII. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

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