STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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

REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code Section 200.830, respectfully submits this Reply Brief on Exceptions to the briefs on exceptions ("BOEs") filed by Commonwealth Edison Company ("ComEd" or the "Company"); the Citizens Utility Board ("CUB"); the Building and Owners and Managers of Chicago ("BOMA"); the Commercial Group (an ad hoc group composed of the Illinois Retail Merchants Association, Best Buy Co, Inc., .J.C. Penny Corporation Inc., Macy's Inc., Safeway, Inc. and Wal-Mart Stores, Inc.); the Illinois Industrial Energy Consumers ("IIEC"); and the Kroger Company ("Kroger"); which were filed on or before July 24, 2008 in response to the Administrative Law Judges' ("ALJs") Proposed Order ("Proposed Order" or "PO") issued on July 10, 2008.

IV. RATE BASE

C. Contested Issues

b. Underground Cable and Services

In its Brief on Exceptions, ComEd argues that, absent the approval of the joint Staff / ComEd recommendations (discussed on pages 4-8 of ComEd's BOE), the PO's adjustment for underground cable and services should be rejected. ComEd BOE, pp. 22-23. Staff disagrees. The PO correctly recognized the merit of adjusting these costs as recommended by Staff, although it reduced that adjustment from a combined $110.95 million to $18.73 million. PO, p. 42. The information Staff sought was a breakdown of the increased costs by materials costs and capitalized labor costs. The Company could not furnish either set of costs, and the PO correctly finds that ComEd failed to fully meet its burden of proof. The Company's Brief on Exceptions offers no new arguments. Staff's responses to ComEd's arguments set forth in its prior briefs are fully set forth in Staff's Initial and Reply Briefs. Staff IB, pp. 13-27; Staff RB, pp. 13-26.

V. OPERATING EXPENSES

C. Contested Issues

1. Incentive Compensation Cost and Expenses

In its Brief on Exceptions, ComEd argues that, absent the approval of the joint Staff / ComEd recommendations (discussed on pages 4-8 of ComEd's BOE), the PO's "approval of Staff's proposed adjustments relating to the AIP net income metric and the LTIP's metrics other than the reliability metrics should not be adopted, or, alternatively, only 50% of the proposed adjustment relating to the AIP net income metric should be adopted." ComEd BOE, pp. 24-25. Staff disagrees. The PO correctly adopted Staff's proposed adjustments relating to the AIP net income metric and the LTIP's metrics

other than the reliability metrics. The Company's Brief on Exceptions offers no new arguments. Staff's responses to ComEd's arguments set forth in its prior briefs are fully set forth in Staff's Initial and Reply Briefs. Staff IB, pp. 34-41; Staff RB, pp. 29-33; *see also* Staff BOE, pp. 35-37.

VI. RATE OF RETURN

C. Cost of Common Equity

As the PO has done (PO, p. 94), 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 Brief on Exceptions

In its Brief on Exceptions, ComEd argues that, absent the approval of the joint Staff / ComEd recommendations (discussed on pages 4-8 of ComEd's BOE), 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 BOE, pp. 27-28. Staff disagrees. The Company's Brief on Exceptions offers no new arguments. Thus, the cost of capital should remain 10.30%, as adopted by the ALJ's PO. Staff's response to ComEd's arguments are fully set forth in Staff's Reply Brief. Staff RB, pp. 39-43.

2. Response to CUB's Brief on Exceptions

In its Brief on Exceptions, CUB continues to recommend a 7.77% cost of equity. CUB BOE, p. 11. As with ComEd's BOE, CUB's BOE introduces no truly novel arguments. Thus, Staff maintains that the Commission should ratify the 10.30% cost of equity adopted in the PO.

CUB's arguments with respect to the Quarterly DCF model again fail to acknowledge that, aside from any incremental costs resulting from imprudent management, the return required by investors **is** the cost of capital rate payers must pay for the use of investors' capital. Granting investors their required rate of return does not constitute an unwarranted "benefit." To accurately measure that investor required rate of return on common equity, the Commission must incorporate the correct timing of dividends. Thus, CUB's claim that an annual DCF model, which assumes an **annual** payment of dividends, "properly match[es] the Commission's rate setting process with the timing of dividend payments" (*See* CUB BOE, p. 7) is absurd, since every company in Staff's Comparable Sample pays dividends on a **quarterly** frequency. Staff Exhibit 4.0 Corrected, Schedule 4.6. Further, there is no "double-counting," since once a utility pays a dividend, rate payers no longer pay a return on that capital; what the investor does with that liquidation of capital (i.e., dividend) is of no concern to the rate payers. Staff more fully addressed this issue in its Initial Brief and Reply Brief. Staff IB, pp. 58-59; Staff RB, pp. 43-44.

CUB also argues against the use of analysts' forecasted growth rates because they are allegedly "biased" and "overly optimistic." CUB BOE, pp. 8-9. Staff disagrees with CUB's implication that analyst growth rates for utilities should be disregarded, generally, as overstated. Staff IB, p. 60. Nonetheless, Staff readily acknowledged that the current level of analyst growth rates, which are forecasts for the next three to five years, appears to be unsustainable over the long-term. Staff Exhibit 4.0, pp. 12-13. However, Staff addressed that issue through the use of a multi-stage DCF model. CUB argues that a multi-stage DCF introduces judgment and uncertainty into the DCF

analysis. Staff agrees. Nonetheless, all cost of equity analyses reflect a degree of judgment and uncertainty. Indeed, the "b x r" (i.e., b times r) growth rate alternative CUB espouses introduces significant judgment and uncertainty in estimating both the retention rate, *b*, that investors expect going forward and the rate of return, *r*, that they expect the company to earn on those retained earnings, as well as in selecting a historical period to represent the "true" average that CUB alleges, without any supporting analysis whatsoever, that investors use to measure growth. CUB's argument does not warrant the rejection of Staff's use of analysts' growth rates, nor does it support the adoption of flawed historical b x r growth rates. Staff more fully addressed this issue in its Initial Brief. Staff IB, pp. 59-63.

CUB argues against the use of CAPM analyses to determine the investor required return on common equity. CUB BOE, pp. 10-11. Of course, the CAPM is an imperfect model; all cost of equity models are imperfect. That is why Staff used both a sample of companies and two models to estimate ComEd's cost of equity. That is also why CUB's proposal to rely on a single model is inappropriate. CUB argues that adjusted betas do not correct the flaws in the model identified in the Nagel paper. However, CUB's argument has no basis, since the Nagel paper studied the use of unadjusted betas relative to the assumption of a universal beta of one, and was silent with respect to adjusted betas. Staff IB, p. 63. CUB inexplicably claims that use of adjusted betas increases the inaccuracy in the CAPM. CUB BOE, p. 11. However, the testimony cited (CUB Ex. 1.0 at 12-13) does not even make that claim, much less support it. In fact, CUB's own evidence contradicts that claim. The Nagel paper found that a market beta of 1.0 is superior to unadjusted betas. Staff Exhibit 17.0, p. 15.

Therefore, Staff's betas, which are adjusted closer toward the market average beta, are also more accurate than unadjusted betas. Furthermore, the Gombola and Kahl article concluded that "an underlying mean of 1.0 is too high for most utilities." CUB BOE, p. 10. Since Staff's adjusted betas are below the market beta, yet CUB argues that Staff's adjusted betas are overstated (CUB BOE, p. 10), then Staff's adjusted betas must be more accurate than the market beta as well. Consistently, the Armitage text that CUB witness Thomas cited found that adjusted betas produce appreciably <u>better</u> forecasts, in direct contradiction to CUB's claim of increased inaccuracy. In fact, the very recent Order from Docket No. 07-0507 states:

> The Commission has reviewed the testimony and arguments offered by CUB in favor of using unadjusted betas and does not find them convincing.
>
> ****
>
> There is simply no support in the record for what appears to be an assumption by Mr. Thomas and CUB that a simplified version of the CAPM, where all betas equal 1.0, would have a lower forecast error than the traditional CAPM if adjusted betas had been used.
>
> ****
>
> In summary, the Commission does not believe that the Nagel Paper, as discussed in the record of this proceeding, undermines the usefulness of the CAPM in establishing the market required rate of return in utility rate cases. In fact, as discussed above, the Commission believes the Nagel Paper tends to support the long-standing proposition to which the Commission has subscribed: that the use of adjusted betas in the CAPM is preferable to the use of unadjusted betas.

Order, Docket No. 07-0507, July 30, 2008, pp. 87-88. Staff more fully addressed this issue in its Initial Brief. Staff IB, pp. 63-64.

For these reasons, and the reasons more fully addressed in Staff's Initial Brief and Reply Brief, CUB's 7.77% cost of equity estimate, and its arguments against Staff's cost of capital analysis, should be rejected. Staff IB, pp. 63-64; Staff RB, pp. 43-44.

VII. NEW RIDERS

B. Rider SMP – Systems Modernization Projects Adjustment

Phase 0

AARP, the AG, CUB and IIEC continue to oppose Rider SMP. AARP BOE, Attachment A, p. 8; AG BOE, p. 15; CUB BOE, p. 14; IIEC BOE, p. 8. In particular, the AG and CUB oppose the funding of Phase 0 through the rider. AG BOE, p. 14; CUB BOE, pp. 14-15 ComEd objects to the PO's recommendation to limit the rider to the Phase 0 project. ComEd, however, would implement Phase 0, but only if the Commission makes prudence and reasonableness findings regarding ComEd's investment in Phase 0. ComEd BOE, p. 37 If ComEd's position in its BOE is that there should be a pre-determination that its Rider SMP investment is reasonable, that position is directly contrary to its own testimony in which it agreed that, if Rider SMP is approved, the approval of a project does not constitute approval of the reasonableness of the actual capital expenditures for such SMP project and may be reviewed for reasonableness and adjusted in a general rate proceeding or annual reconciliation process. ComEd Ex. 43.0, pp. 22-23, lines 483-495. Staff witness Hathhorn agreed with ComEd at the evidentiary hearing that its proposed language to preserve Staff's right to review the reasonableness of Rider SMP costs is appropriate. Tr. 663. To the extent that ComEd's proposal now is to disregard or dispose of any reasonableness

review of Phase 0 in a future rate case or reconciliation proceeding, that position would be contrary to its witnesses' representations in this docket.

Staff accepts the PO's recommendation that Rider SMP should be approved for the limited purpose of funding Phase 0, but only as long as Phase 0 is viewed as an experimental or pilot program to be used for evaluation purposes in connection with the smart grid workshops. In this respect, Staff's position appears to be exactly opposite that of ComEd's. ComEd states that the Commission should not approve Phase 0 if the Commission determines that Phase 0 workshops should be undertaken. Staff agrees with AARP, the AG, CUB and IIEC that Rider SMP should not be approved if Phase 0 is not intended to be an experimental program that will be used as an input in evaluating the scope and nature of future smart grid investments in ComEd's service territory.

Phase 0 results could serve as a key source of information when workshop participants and the Commission evaluate whether AMI should be expanded throughout the ComEd service territory and the remainder of the state. For example, Phase 0 results would enable ComEd and all workshop participants to more precisely quantify the potential costs and benefits of full-scale AMI deployment. PO, p. 134. Given the expected approximately billion dollar price tag of full-scale deployment in ComEd's service territory alone, having a better understanding of potential statewide costs and benefits than is provided in the scanty evidentiary record about those matters in this case is critical. AG/CUB Ex. MLB-4.0; 18; 1-4.

Workshops

While Staff understood the PO to call for a single workshop that would consider both Phase 0 and the policy goals listed in the PO, the AG, ComEd and CUB read the

PO to call for two workshops addressing these two topics. AG BOE, p. 14; CUB BOE, p. 15; ComEd BOE p. 39 Staff is not prepared to argue that two separate workshop processes are required – all information available about smart grid and AMI should eventually be considered in any Commission determinations about those issues in either event. Moreover, in Staff's view, a statewide proceeding to consider the subjects for the whole state is the best process anyway, and adding ancillary workshops seems to unnecessarily complicate the overall process.

Whether one workshop or two, as noted above, Staff believes that Phase 0 should be undertaken only if Phase 0 results are included in workshop discussions. Staff BOE, p. 44. The duration of the workshop process whether it is a separate workshop devoted entirely to Phase 0 matters or a workshop process that will consider Phase 0 implementation results along with a wider examination of statewide AMI and smart grid issues, must be sufficiently long to (1) enable ComEd to implement Phase 0; (2) evaluate Phase 0; and (3) bring the results of its evaluation to the workshop process. The workshop process, standing alone, or the Phase 0 portion of a more comprehensive workshop, thus would likely last until approximately the end of 2009. Staff notes that the Energy Security and Independence Act of 2007 ("EISA") investigation of smart grid issues must also be completed by December 2009. PO, p. 134. The Commission may thus wish to consider combining the EISA investigation with the workshops that commence after this proceeding.

C. Rider SEA – Storm Expense Adjustment

The PO was absolutely correct in concluding that Rider SEA should be rejected. The Company does not provide anything new substantively in its BOE. Instead, ComEd repeated the same arguments made previously in its Reply Brief, Initial Brief, and Testimony. In its BOE ComEd initially states, "Rider SEA would provide a superior match of storm–related revenues and costs that would benefit customers and the Company alike." ComEd contends that "[w]ithout the rider, it is a near certainty that in any year the Company will either over or under recover its storm-driven costs." ComEd BOE, p. 43.

This is an argument ComEd or any other utility could make about every cost on its system. If it implemented a rider for each cost, then the issue of a mismatch between costs and revenues would never arise. However, there is a clear and obvious downside to this guarantee of cost recovery for the utility. That guarantee undermines the incentive for the utility to control costs. Whether the Company adopts prudent practices with respect to preparing for and responding to storm damage, the proposed Rider SEA provides the opportunity for full rider recovery. Either way, there will be no impact on the utility's bottom line. Staff does not believe that good practices will be encouraged when the utility's incentives to control its costs are weakened.

ComEd goes on to contend that "the minor additional administrative burden imposed on Staff by rider [SEA] is a modest 'cost' for the undisputable benefit it would provide to both customers and the Company. ComEd BOE, pp. 43-44This statement is flawed in two respects. First, there is no evidence to demonstrate that the administrative burden the rider would impose on Staff would be minor or provide an acceptable balance between administrative resources and ratepayer protection.

For instance, 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, 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. ICC Staff RB, p. 71 In fact, oversight could quickly become complex in seeking to sort out which costs are due to storm damage and which result from wear and tear. If, for example, a pole that was already rotting and needing to be replaced soon were to fall down during the storm, the Commission would have a difficult time figuring how much, if any of the associated costs for that single item should flow through Rider SEA. For a storm that causes widespread damage, the problem of sorting out which costs should flow through the rider would rise exponentially.

Second, the "undisputable benefit" of the rider "for both customers and the Company" is, in fact, quite disputable, at least as far as customers are concerned. Because the rider undermines the utility's financial incentive to control storm costs, that exposes ratepayers to higher storm expenses than necessary through recovery under the rider.

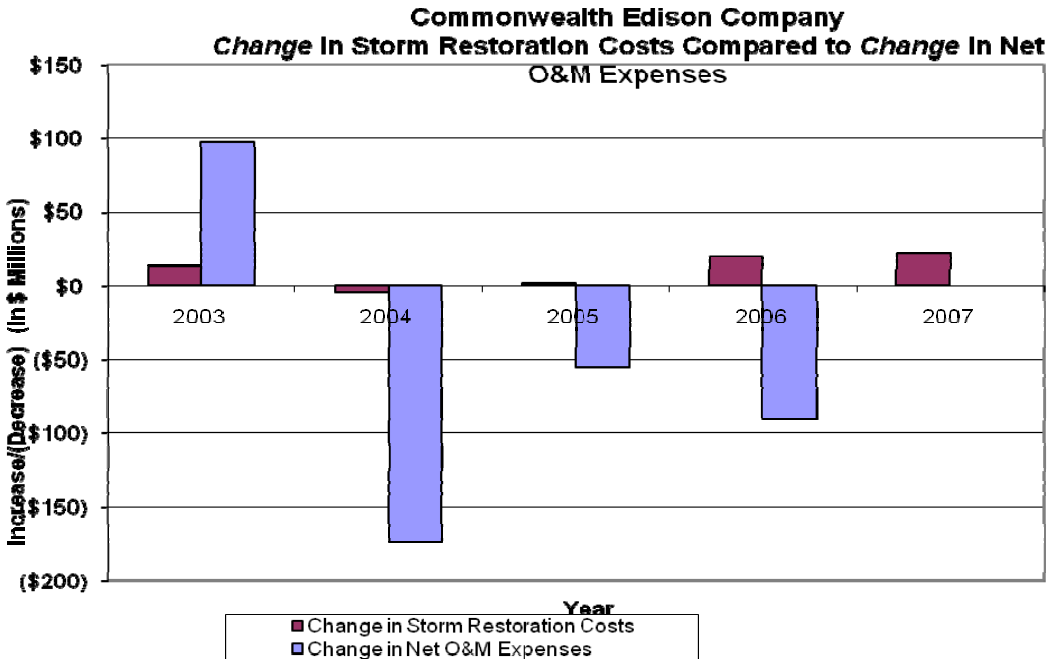
The Company then provides a brief capsule of additional arguments presented for its proposed rider as follows:

> (1) ComEd's storm repair O&M expenses are material (*i.e.*, they involve very large costs), highly volatile from year to year, and unpredictable and uncontrollable (Williams Dir., ComEd Ex. 4.0 Corr., 66:1329-32); (2) storm repairs are a substantial part of ComEd's distribution corrective

> maintenance work, representing approximately 18.8% of all such expenses, which, in turn, affects expenditures on other projects and programs (Williams Reb., ComEd Ex. 22.0 Corr., 9:175-10:184); and (3) a review of historic storm expenses confirms that such amounts are inherently unpredictable, reflecting annual differences of -71% and 102%, respectively, and a range of $47 million. ComEd Init. Br. at 88; Luth Dir., Staff Ex. 6.0, 15:260-68. Clearly, the Proposed Order's conclusion that storm costs are not of a sufficient magnitude or volatility is in direct conflict with the evidentiary record.

ComEd BOE, p. 45. These arguments by ComEd have been previously discussed and found to be lacking. With regard to the claim that these "involve very large costs" (*id.)*, Staff would note testimony by the Company's own witness, Mr. Williams, who stated "It is true that, compared to total revenue, storm costs are relatively small." ComEd Ex., 22.0 Corrected, p. 9.

Furthermore, Staff provided the following graph that shows the Company's storm restoration expenses are not significant in comparison to their operating expenses. ICC Staff IB, p. 86



*Data taken from ICC Staff Ex. 18.0, Schedule 18.01

The above graph shows that fluctuations in storm-related expense, while expected, are insufficient to trigger frequent general rate proceedings if they are recovered under base rates. ICC Staff Exhibit No. 6.0, 14-15:252-258) Thus, there is no justification to warrant the drastic departure from traditional ratemaking that the proposed rider would represent.

Lastly, the Company contends:

> the Proposed Order improperly concludes that Rider SEA's recovery mechanism would remove incentives for ComEd to control its storm expenses. Proposed Order at 151. ComEd presented testimony explaining why the Commission's annual review of the reasonableness of ComEd's storm expenses is more than sufficient incentive for ComEd to properly classify or define a cost as eligible for recovery under the rider and to manage its storm restoration efforts efficiently.

ComEd BOE, p. 45. This argument is inaccurate. Instead of aggressively avoiding costs, ComEd will have an incentive under the proposed rider to pass along to ratepayers as many costs as possible. Rider recovery shifts the burden of determining which costs are properly categorized to Staff who would need to identify and show which costs do not belong. Invariably, some inappropriate costs would not be identified, creating an incentive for ComEd to continue to be over-inclusive. If Staff does identify costs that do not belong in the rider, the only downside for ComEd will be an inability to recover costs that were improperly included in the rider anyway. Furthermore, for those inappropriate costs that Staff fails to identify, ComEd will receive a financial benefit if they are recovered under the rider. Thus, the rider gives ComEd the incentive to propose as many costs for the recovery mechanism. ICC Staff Exhibit 8.0, 4:70-75

In its BOE, ComEd attacks the PO's reasoning , alleging that "[i]n concluding that Rider SEA should be rejected, the PO misapplies the legal standard for the Commission's authority regarding riders (contrary to the Commission's recent decision

in its *Peoples* Order), ignores ComEd's evidentiary showing and improperly speculates, without any persuasive evidentiary support, about ComEd's motives with respect to controlling storm expenses." ComEd BOE, p. 44. ComEd is incorrect with respect to each of these allegations. As to ComEd's claim that the PO improperly speculates as to ComEd's motives, ComEd fails to identify any citation or to otherwise support this baseless allegation. As to ComEd's claim that the PO fails to consider ComEd's evidence, ComEd again fails to support this allegation. In fact, the PO clearly considered ComEd's evidence but found it lacking. As the PO succinctly states:

> ComEd has not provided a compelling reason to warrant this special rider treatment for costs that are typically recovered through base rates. Variations in storm expenses are adequately addressed through normalization, which alleviates concerns that the test year expense might be an anomaly. The addition of a yearly reconciliation proceeding adds unnecessary complexity to a cost that has historically been recovered through base rates.

PO, p. 151.

Unfortunately, ComEd in its Brief on Exceptions attempts to distract the Commission from the facts and their relevant application to the law. ComEd continues to argue without support that its storm repair O&M expenses are "material (i.e., they involve very large costs), highly volatile from year to year, and unpredictable and uncontrollable…." ComEd BOE, p. 44; Williams Dir., ComEd Ex. 4.0 Corrected, 66:1329-32. Staff maintains, and the PO agrees, that the Company has not presented any specific or viable information to demonstrate sufficient volatility to justify rider recovery, and nothing in ComEd's BOE should persuade the Commission that this demonstration has been made.

As to ComEd's allegation that the PO misapplies the legal standard for the Commission's authority regarding riders, ComEd is again incorrect. The PO

acknowledges the flexibility inherent in the Commission's authority while continuing to rely upon the Commission's general practice of permitting rider treatment only in those unique circumstances that justify a deviation from traditional ratemaking. As the PO explained:

> The Commission has the authority to approve riders in the appropriate circumstances. The Company, however, has not shown that this is the appropriate circumstance.
>
> Staff's Initial Brief succinctly sums up the problems with Rider SEA by stating that "costs are not of sufficient magnitude or volatility to justify rider recovery. Furthermore, the rider's pass-through mechanism would undermine the Company's incentive to control storm expenses." Staff Init. Br. at 82.

PO at 151. While ComEd acknowledges that the PO "properly concludes that the Commission has the authority to approve riders in the 'appropriate circumstances,'" ComEd objects that the PO "improperly limits those circumstances to where the costs are of 'sufficient magnitude or volatility.'" ComEd BOE, p. 44 (citing PO, p. 152). The PO does not, however, improperly limit the circumstances considered for rider treatment, it merely finds that ComEd has not provided persuasive evidence warranting such treatment. PO., p. 151 ("ComEd has not provided a compelling reason to warrant this special rider treatment…") ComEd's argument amounts to nothing more than an inappropriate attempt to convert its evidentiary failure into a non-existent legal issue. Rider SEA has been treated by all parties as presenting a fact question regarding the unexpected, volatile or fluctuating nature of the costs at issue. Indeed, ComEd itself admits that its evidence attempted to address this issue. ComEd BOE, pp. 44-45. There is no legitimate basis to assert that the PO applied an incorrect legal standard in considering the evidence presented on this issue.

In discussing the legal standard for rider treatment, ComEd appears to be implying that the Commission should approve Rider SEA even if the Commission cannot make_a finding that storm related costs are unexpected, volatile, or fluctuating. Each statement of ComEd regarding the law of riders is in itself accurate. For instance, ComEd states the following:

> Instead, the case law holds that use of a rider is not limited "only to those cases where expenses are unexpected, volatile, or fluctuating." *City of Chicago v. Illinois Commerce Comm'n,* 281 Ill. App. 3d 617, 628 (1st Dist. 1996) The Commission recently confirmed in Peoples that there are no "all-or-nothing factors" for approval of a rider. Peoples Order at 186.

ComEd BOE at 44. The context of these statement, however, clarifies that the Commission's practice has been to award rider treatment only in those circumstances that justify the deviation from traditional rate making treatment. In citing the *City of Chicago* case, ComEd failed to include relevant language that clarifies that while the Commission has expansive authority, that authority nevertheless requires a showing that the circumstances must warrant rider recovery and the costs in question must be unique. Immediately preceding the language quoted by ComEd, the *City of Chicago* case states, "…The rule does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such a treatment." *City of Chicago v. Illinois Commerce Comm'n,* 281 Ill. App. 3d 617, 628 (1st Dist. 1996), citing to *Citizens Utility Board*, 166 Ill. 2d at 138, 651 N.E. 2d at 1102.

In this case, storm expenses are not "unique costs" nor do the circumstances surrounding such expenses justify deviation from the traditional ratemaking treatment. As IIEC witness Stephens 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,

36:754-757. Similarly, ComEd's statement quoted above regarding the Peoples Order fails to provide sufficient context. Although the Commission acknowledged its broad authority to consider all of the circumstances regarding a request for rider treatment, the Commission in the Peoples Order reiterated that rider recovery should be based upon unique circumstances, namely, whether the costs are volatile, unpredictable and independent of utility control:

> In prior cases, **the prerequisites for rider recovery have been that the relevant costs are volatile, unpredictable and independent of utility control**. Again these are not all or nothing factors. Thus for example, a modicum of cost volatility will not automatically warrant rider recovery, and a modicum of cost consistency will not necessarily preclude rider treatment.

Peoples Order, p. 186. Therefore, the relevant considerations for rider recovery continue to be that "the relevant costs are volatile, unpredictable and independent of utility control." *Id*. While Staff agrees that the Commission has discretionary authority under the PUA in appropriate circumstances to provide for rider recovery (*City of Chicago v. Illinois Commerce Comm'n,* 13 Ill. 2d 607 (1958)), the Company must demonstrate adequate justification for deviating from traditional ratemaking principles. A rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses (*Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 138-139 (1995)), but as the PO correctly determined the Company has not presented any specific or viable information to demonstrate sufficient volatility to justify rider recovery. "ComEd has not provided a compelling reason to warrant this special rider treatment for costs that are typically recovered through base rates." PO, p. 151.

Finally, while not directly relevant to the outcome here given ComEd's evidentiary failure, it must be noted that the Commission's authority to approve a rider is a discretionary authority. *Citizens Utility Board v. Illinois Commerce Comm'n, 166 Ill. 2d 111, 138-139 (1995)*. ("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**."); *Ill. Power Co. v. Ill. Commerce Comm'n*, 339 Ill. App. 3d 425, 434 (1st Dist. 2003) ("In *City of Chicago v. Illinois Commerce Comm'n, 13 Ill. 2d 607, 150 N.E.2d 776 (1958)*, the Illinois Supreme Court highlighted the Commission's discretionary authority to allow a rate recovery for a utility's costs through a purchased-gas adjustment tariff."). Thus, even if ComEd had established that rider recovery of these costs was allowable under the facts of this case, which it has not, that would not mandate rider recovery under the law. Rather, even where rider recovery is within the Commission's authority the decision to allow rider recovery rather than base rate recovery is a matter left to the sound discretion of the Commission. Thus, it is ComEd who engages in a flawed application of the law via its argument that would allow the Commission no discretion.

VIII. Cost of Service and Allocation Issues

The exceptions taken to the PO's conclusions on revenue allocation and rate design should be rejected. The Commission should adopt the PO's recommendation to increase existing revenues and rates by an equal percentage, across-the-board basis, rather than according to costs as some parties propose.

The parties seeking a cost-based revenue allocation and rate design present a number of arguments on the issue. BOMA argues that "an across the board rate increase ignores historical inequities in addition to neglecting valid cost of service studies provided in this proceeding." BOMA further contends that "[b]y deviating from cost-based rate making principles, the Commission fosters existing and continuing rate subsidies, both inter and intra-class." BOMA BOE, p. 9.

The Commercial group contends that "[t]he ALJs ignore the fact that <u>all class cost studies in evidence in this case show the Medium, Large, and Very Large Load classes providing returns substantially above cost</u>." Commercial Group BOE, p. 2. Kroger argues that in contrast to the PO's conclusion, the across-the-board approach "does pick winners and losers". Kroger identifies the winners as "the customers that are currently receiving subsidies from other classes" and the losers as "the customers that are currently subsidizing other customers." Kroger BOE, p. 2.

ComEd, for its part, argues that "The Proposed Order abandons years of settled Commission rate policy" by adopting an across-the-board approach. The Company goes on to contend that this approach "will exacerbate existing rate subsidies for certain customer classes and create new rate subsidies for other customer classes". The Company also maintains that this conclusion "will make ComEd's and the Commission's future efforts to set rates based on cost even more difficult, as those customers enjoying the new or larger subsidies resulting from this case likely will complain even more vehemently the next time ComEd proposes to set rates based on cost." ComEd BOE, pp. 46-47.

The problem with these arguments is they fail to account for the unique and difficult circumstances electric ratepayers in Illinois currently face. ComEd customers have already absorbed a number of significant increases in their electric bills and evidence from the Company indicates further increases may be expected on a frequent basis in the future.

It should be remembered that ComEd customers have continued to receive increases since January 2, 2007. For example, ComEd recently completed a transmission rate case that features an increase of $93 million in the transmission revenue requirement as well as the inclusion of CWIP in rate base and a return on equity adder for a West Loop project. (Exelon's January 23, 2008 Earnings Announcement at http://www.exeloncorp.com/aboutus/news/pressrelease/corporate/Press+Release+-+012308.htm, viewed April 1, 2008) Power costs for bundled customers increased on June 1 of this year with the average bill increase for residential customers estimated by ComEd at approximately 2.5%. (http://n01.moneycentral.msn.com/ticker/article.aspx?symbol=US:EXC&feed=PR&date=20080312&id=8327457, viewed April 1, 2008)

In this docket, ComEd has filed for a rate increase of $361.3 million which, if accepted, would raise residential bills by almost 8% (absent the impact of the rate rebate). ComEd Ex. 1.0, 18:176-180. The Company also proposes in this docket to institute Rider SEA and Rider SMP that would allow recovery of additional revenues from ratepayers on a going-forward basis beyond the rate increase granted in this proceeding. For example, Rider SMP alone could increase delivery service bills by as

much as 5% per year under the rate cap proposed by ComEd, while the Company presents no cap on the increases that would be permissible under Rider SEA. Staff Ex. 18.0, 19-20:440-448.

Furthermore, the Company indicated that plans are afoot to seek further delivery service rate increases in the immediate future. When asked whether it was ComEd's intention to file more frequent rate cases, the Company responded "that it expects to make regular rate requests as part of our effort to put ComEd on a path toward appropriate returns." Staff Ex. 18.0, 20:450-455.

Already, a number of extraordinary steps have been taken in response to these increases. ComEd and its parent company, Exelon, were required to mitigate the impact of the recent rate increase through the offer of approximately $500 million in rebates to ComEd ratepayers. Staff Ex. 18.0, 18-19:412-422. The Commission, for its part, found it necessary to launch an investigation of ComEd's rates to address concerns raised by ComEd customers to members of the General Assembly and others. (Initiating Order, Docket No. 07-0166, p. 2, March 2, 2007)

Clearly, bill impacts are an overriding concern for the Company, Commission and ratepayers. The most reasonable approach to address these concerns is an equal percentage, across-the-board increase on existing rate elements. This approach recognizes that all ComEd ratepayers have been stressed by significant increased in electricity costs that may very well continue for the foreseeable future. It is most equitable under these circumstances to apportion increases as equally as possible, which is the purpose of an across-the-board, equal percentage increase.

The across-the-board approach is particularly appropriate given the Commission's recent investigation of ComEd's rates to address bill impacts concerns (Docket No. 07-0166). To revise those rates so soon after that rate investigation would not make sense with ratepayers facing further bill increases as a result of this proceeding. The across-the-board approach maximizes consistency with the rates approved in Docket No. 07-0166 because it preserves existing rate relationships for retail customers.

Thus, the PO's recommendation for an across-the-board increase in existing rates should be accepted in this case.

XII. Findings and Ordering Paragraphs

1. Finding 12

ComEd takes exception to finding 12 of the PO which provides that ComEd shall file its compliance tariffs with an effective date of no less than thirty (30) days after the date of filing. ComEd BOE, pp. 61-62. Staff's position is that 30 days is likely more time than is necessary for a review of the tariffs ComEd will submit at the conclusion of this proceeding. However, Staff believes that the solution proposed by the Company of four calendar days is clearly insufficient, especially if any of those days fall on a weekend. That would not allow Staff enough time to review the complicated tariffs that are filed as a result of a complex and contentious delivery services case. Staff believes the alternative of making the tariff sheets (with the exception of SMP and SEA tariff sheets discussed below) effective five business days after their filing provides a reasonable balance between the desire on the part of the Company to begin charging its new rates and the needs of the Commission and Staff to review the tariffs.

Accordingly, Staff recommends that the Company's language be rejected and that the following language change be made to the PO instead:

> (12) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than five business ~~thirty (30)~~ days after the date of filing, with the tariff sheets to be reviewed by the ~~Rates Department~~Staff of the Commission, and corrected, if necessary, within that time period;

However, if the Commission approves some form of Rider SMP and/or SEA, then Staff will need additional time to review those compliance tariffs because the proposals, particularly Rider SMP, have undergone significant changes by Staff, the Company, Intervenors, and the ALJs, since the Company filed its proposed tariffs. The Company itself admitted that in preparing its surrebuttal testimony that it only was able to review the substance of the proposed changes and had only addressed the specific language of one of Staff's proposals. It further requested flexibility to work with Staff during the preparation of its compliance filing for Rider SMP to incorporate the modifications. ComEd Ex. 43.0, p. 21, lines 447-452. In addition, these new tariffs cover new and unexplored areas, all of which will require more time for Staff to conduct a thorough review of the compliance filing. Since these riders would implement rates on a historical basis, i.e. they collect only for money previously spent, there is no rush to have in place a tariff so long as the final tariff complies with the Commission Order and provides for the relief approved. Accordingly, Staff recommends the following alternative language if some form of Rider SMP and/or SEA is approved by the Commission.

> (12) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than five business ~~thirty (30)~~ days after the date of filing, with the exception that tariff sheets for Rider SMP and Rider SEA [if approved] shall reflect an effective date not less than 15 business days after the date of filing, with the tariff sheets to be reviewed by the ~~Rates Department~~Staff of the Commission, and corrected, if necessary, within that time period;

XIII. CONCLUSION

WHEREFORE, for all the reasons set forth herein, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding.

Respectfully submitted,

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