

Admitted
8/20/09

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)
)
Petition to approve an Advanced Metering)
Infrastructure Pilot Program and associated tariffs)

Docket No. 09-0263

DIRECT TESTIMONY OF MICHAEL L. BROSCHE
ON BEHALF OF
PEOPLE OF THE STATE OF ILLINOIS AND AARP

AG/AARP Exhibit 1.0

JULY 24, 2009

OFFICIAL FILE

I.C.C. DOCKET NO. 09-0263
AG/AARP Exhibit No. 1.0
Witness _____
Date 8/26/09 Reporter TS

DIRECT TESTIMONY OF MICHAEL L. BROSCH

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I. INTRODUCTION / SUMMARY

2 Q. Please state your name, occupation and address.

3 A. My name is Michael L. Brosch. My business address is Utilitech, Inc. PO Box
4 481934, Kansas City, Missouri 64148-1934.

5 Q. By whom are you employed?

6 A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in
7 utility rate and regulation work. The firm's business and my responsibilities are
8 related to special services work for utility regulatory clients. These services include
9 rate case reviews, cost of service analyses, jurisdictional and class cost allocations,
10 financial studies, rate design analyses and focused investigations related to utility
11 operations and ratemaking issues.

12 Q. On whose behalf are you appearing in this proceeding?

13 A. I am appearing on behalf of the People of the State of Illinois represented by the
14 Attorney General ("AG") and AARP in order to review and respond to the Rider
15 Advanced Metering Program Adjustment ("Rider AMP") cost recovery proposals
16 being raised by Commonwealth Edison Company ("ComEd" or "the Company").

17 Q. Will you summarize your educational background and professional experience
18 in the field of utility regulation?

19 A. AG/AARP Exhibit No. 1.1 is a summary of my education and professional
20 qualifications. I have testified before utility regulatory agencies in Arizona,
21 Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan,
22 Missouri, New Mexico, Ohio, Oklahoma, Utah, Washington, and Wisconsin in

1 regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and
2 steam utilities. In Illinois, I have testified in several major energy rate proceedings
3 before the Commission, including Peoples Gas Light & Coke Company (“PGL”) rate
4 cases in Docket No. 90-0007 and then more recently involving PGL and North
5 Shore Gas in Docket Nos. 07-0241 and 07-0242. I also have submitted testimony
6 in the recent Commonwealth Edison Company rate case, Docket No. 07-0566 and
7 in the most recent rate cases of the Ameren Illinois Utilities in consolidated Docket
8 Nos. 07-0585 through 07-0590. My testimony in the last ComEd rate case
9 addressed the Company’s proposed Riders SMP and SEA.

10 **Q. Have you previously participated in energy utility regulatory proceedings in**
11 **other states?**

12 A. Yes. I have participated in numerous electric and gas regulatory proceedings, as
13 listed and described in AG/AARP Exhibit No. 1.2. My experience involves
14 traditional rate increase or rate reduction cases, as well as various forms of rate
15 adjustment tariff riders and accounting deferral proposals that I have addressed on
16 many prior occasions.

17 **Q. What is the purpose of your testimony in this docket?**

18 A. In its Order dated September 10, 2008 in the Company’s last rate case, the
19 Commission declined to approve ComEd’s proposed Rider SMP except for, “the
20 very limited purpose of implementing Phase 0 – a scaled deployment of AMI – as a
21 pilot program.”¹ The Company has now submitted its Petition and supporting

¹ Illinois Commerce Commission Final Order, September 10, 2008 in Docket No. 07-0566, page 138.

1 testimony seeking to implement rider recovery for its AMI pilot program.
2 However, instead of complying with the referenced Order, now ComEd seeks to
3 rename and implement a proposed “Rider AMP” that is captioned “Advanced
4 Metering Program Adjustment”. ComEd’s proposal would expand the scope of the
5 Rider SMP that was approved by the Commission, to now include expensed costs
6 as well as capital investment, ~~and to also include unspecified and vaguely defined~~
7 ~~costs of potential future “Federal Stimulus Projects”~~. The Company has also
8 proposed a second new “Rider AMP-CA” that is captioned “Advanced Metering
9 Program Customer Applications Experiment” that was not approved in Docket No.
10 07-0566.

11 My testimony addresses regulatory policy concerns raised by ComEd’s
12 Petition to expand the scope of the narrowly defined System Modernization Project
13 Rider that was approved by the Commission in Docket No. 07-0566, as later
14 renamed “Rider AMP” or Advanced Metering Program Adjustment. In particular,
15 my testimony explains the piecemeal ratemaking, administrative complexity, risk
16 shifting and prudence review concerns caused by ComEd’s proposed expansion of
17 Rider AMP. Additionally, I provide information that indicates how ComEd is able
18 to fund and should be expected to fund its AMI expenses and customer application
19 initiatives without extraordinary rate tracker cost recovery, for future recovery
20 through normal ratemaking procedures. My testimony also rebuts specific claims
21 of the Companies’ witnesses in support of the proposed expansion of Rider AMP.
22 Finally, I respond to the Company’s proposed 10-year amortization period for the

1 regulatory asset arising from the premature retirement of existing electric meters in
2 connection with the AMI Pilot.

3 **Q. Please summarize the recommendations that are set forth in your testimony.**

4 A. In general, I continue to recommend that the Commission reject piecemeal rate
5 adjustment riders for isolated elements of utility revenue requirements in the
6 absence of compelling evidence that such piecemeal rate adjustments are warranted.
7 However, recognizing that the Commission has already approved a limited scope
8 Rider AMP for recovery of capitalized costs expected to be incurred in connection
9 with ComEd's AMI Pilot, my testimony explains why the form of Rider AMP, as
10 previously approved by the Commission in Docket No. 07-0566, is sufficiently
11 compensatory to ComEd and should not be expanded to include expensed costs for
12 customer applications testing. In the testimony that follows, I sponsor the following
13 recommendations to the Commission:

- 14 • Rider AMP should not be expanded to include expensed costs incurred in
15 connection with the AMI Pilot Customer Applications expenses.
- 16 • ~~ComEd has not justified its open ended proposal to expand Rider~~
17 ~~SMP/AMP to also include unspecified future Federal Stimulus projects.~~
- 18 • The un-depreciated costs of meters that are retired in connection with the
19 AMI Pilot should be recovered over no less than 13 years, rather than the
20 10 year period recommended by ComEd witness Fruehe.²

² ComEd Ex. 5.0, lines 67-158.

1 These conclusions are based upon my understanding of the general regulatory
2 policies applicable to exceptional rate rider cost recovery, as well as this
3 Commission's application of such policies.

4 **Q. What are the basic criteria that regulatory commissions have employed to**
5 **evaluate the need for rate Rider treatment of utility costs?**

6 A. Cost recovery riders should be approved only in instances where compelling
7 circumstances justify departure from traditional test period review of all costs and
8 revenues within rate case proceedings in which the overall revenue requirement can
9 be audited and considered in a balanced and synchronized manner. Costs or revenue
10 changes to be deferred or tracked through a rider should generally have all of the
11 following attributes to merit such exceptional and preferential rate recovery
12 treatment:

- 13 1. Substantial enough to have a material impact upon revenue
14 requirements and the financial performance of the business between
15 rate cases.
- 16 2. Beyond the control of management, where utility management has
17 little influence over experienced revenue or cost levels.
- 18 3. Volatile in amount, causing significant swings in income and cash
19 flows if not tracked.
- 20 4. Straightforward and simple to administer, readily audited and
21 verified through expedited regulatory reviews.
- 22 5. Balanced, such that any known factors that mitigate cost impacts are
23 accounted for in a manner that preserves test year matching
24 principles.

25 The relatively modest amounts of AMI Pilot Customer Applications expenses ~~and~~
26 ~~the open ended proposal for Rider recovery of federal stimulus funded projects do~~
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1 not meet these criteria and should not be recoverable through expansion of the
2 existing Rider SMP/AMI.

3
4 **II. RIDER SMP/AMP - AS APPROVED BY THE COMMISSION**

5 **Q. What was the purpose for Rider SMP, as it was proposed by ComEd in the**
6 **Company's last rate case, Docket No. 07-0566?**

7 A. Rider SMP was proposed by ComEd in its last rate case to assist the Company in
8 making new investments in technology to achieve "system modernization", with
9 particular emphasis upon Smart Grid technologies. The Company argued that, to be
10 able to deliver the benefits of Smart Grid technologies, the new Rider SMP
11 mechanism was needed to both provide regulatory certainty about the prudence of
12 those investments before they are made and allow ComEd timely cost recovery of
13 its capital costs.³ Since this tariff has since been renamed, I will refer to it in the
14 rest of this testimony as Rider SMP/AMP.

15 **Q. Was Rider SMP/AMP, as considered and approved by the Commission,**
16 **limited to only the capitalized costs associated with new investments in**
17 **technology?**

18 A. Yes. As noted in the Commission's Order, ComEd witness Mr. Crumrine stated in
19 his rate case testimony, "The intent of this rider is to treat the capital costs of these
20 projects in a similar manner as the Commission would in a rate case, but with more

³ See Final Order, September 10, 2008 in Docket No. 07-0566, at 103. In an Amending Order dated November 3, 2008, the Commission revised the September 10 Order to "state that the costs of the Phase 0 AMI workshops, including the third party facilitator, may be capitalized and recovered through the system modernization rider on [an] amortized basis."

1 timely recovery between rate cases.”⁴ There was no reference to expensed costs
2 being recovered through the infrastructure rider in the rate case.

3 **Q. What is the significance of allowing Rider SMP/AMP treatment for “capital**
4 **costs” but not for utility operating expenses?**

5 A. Capitalized costs are incurred in connection with the addition of an asset to the
6 utility’s system, typically adding Utility Plant in Service, for which benefits to
7 customers extend into the future, over the useful life of that new plant asset. In
8 contrast, costs that are required to be expensed are related to spending that provides
9 benefit only in the current period and that are not an “investment” for the longer
10 term benefit of ratepayers. Expenses relate to shorter term efforts and activities that
11 do not represent investments.

12 When Rider SMP/AMP was considered by the Commission in Docket No.
13 07-0566, the Company’s claimed need for the Rider was to enable and encourage
14 ComEd to invest in new technologies that will provide long-term benefits to its
15 customers. In that same Docket, ComEd also proposed Rider SEA to track and
16 automatically adjust rates for fluctuations in storm restoration expenses, but Rider
17 SEA was rejected by the Commission with the statement, “ComEd has not provided
18 a compelling reason to warrant this special rider treatment for costs that are
19 typically recovered through base rates. Variations in storm expenses are adequately

⁴ *Id.* page 110. ComEd Ex. 11.0 at 17.

1 addressed through normalization, which alleviates concerns that the test year
2 expense might be an anomaly.”⁵

3 **Q. Did the Commission also employ the same “large” and “volatile” criteria in**
4 **resolving rate rider expense tracking proposals in its Order in Commonwealth**
5 **Edison’s previous rate case, Docket No. 05-0597?**

6 A. Yes. In that case, ComEd sought to expand the scope of its existing environmental
7 cost recovery Rider ECR, to include more than manufactured gas plant (“MGP”)
8 remediation costs. At page 212 of its Order, the Commission stated:

9 Based on ComEd’s own graph (Exhibit 44.0 – Attachment 1) and
10 the testimony of ComEd’s own witness, the non-MGP costs are not
11 as large or as volatile as the MGP costs. The Commission agrees
12 with Staff that the Company has failed to demonstrate that non-
13 MGP cost are reasonable, prudently incurred, related to delivery
14 costs and are as volatile as MGP costs. The Commission also
15 notes that there is no precedent for recovery of non-MGP costs
16 through a rider. The Coal Tar Cases only involved costs related to
17 MGP sites. Therefore, the Commission rejects the inclusion of
18 non-MGP costs in the proposed Rider ECR.

19
20 **Q. Rider SMP/AMP was approved for the narrow purpose of expediting cost**
21 **recovery of the return and depreciation on newly capitalized investments**
22 **associated with ComEd’s AMI Pilot Program. Why treat costs that are**
23 **capitalized differently than costs that are expensed?**

24 A. Capitalized costs are accumulated as assets in rate base and are normally “captured”
25 in ratemaking when rate cases occur and the utility’s rate base is updated, so as to
26 account for changes in the level of Plant in Service assets that have occurred since
27 the previous rate case. These changes occur routinely as new plant is added and old

⁵ *Id.* page 159.

1 plant is replaced and retired. Thus, capitalized costs for new Plant in Service
2 represent investments in new plant assets or technology that are recoverable from
3 ratepayers over multiple future years. When plant is added to rate base, it remains
4 in the investment base that is allowed to earn a return on investment and that is
5 depreciated in determining future revenue requirements. This “cumulative”
6 accounting for the capitalized costs of Plant in Service means that every dollar
7 expended and capitalized is assured of rate recovery over the life of the asset,
8 subject to either the timing of rate cases or the terms of any special rider recovery,
9 such as Rider AMP, between rate cases.

10 **Q. In contrast to capitalized costs for new investment, do the specific expenses**
11 **that are incurred by a utility change significantly from year to year?**

12 **A.** Yes. The costs incurred in connection with the efforts of employees and contractors
13 that do not create new utility assets must be expensed on the books. Thus, the
14 composition of specific activities and expenses in any particular test year will never
15 exactly repeat itself, but the adequacy of overall expense levels is the issue of
16 importance for ratemaking.

17 It is not unusual for utility Operations and Maintenance (“O&M”) expenses
18 to fluctuate significantly from month to month and year to year, as new programs
19 and priorities are initiated while others are completed or discontinued. For
20 example, programmatic work on vegetation management or software development
21 projects can cause significant changes in discrete types and amounts of expenses in
22 any particular year. Similarly, as noted in Docket No. 07-0566, storm restoration

1 costs are incurred erratically and in patterns that are difficult to predict. However,
2 what is important for ratemaking is that the overall level of total expenses and the
3 return on and of rate base (rate of return and depreciation) remain reasonably
4 aligned with the overall level of utility sales revenues. When revenues and overall
5 costs become misaligned, rate cases are required to correct the imbalances.

6 In rejecting Rider SEA in ComEd's last rate case, the Commission stated,
7 "Staff's Initial Brief succinctly sums up the problems with Rider SEA by stating
8 that 'costs are not of sufficient magnitude or volatility to justify rider recovery.
9 Furthermore, the rider's pass-through mechanism would undermine the Company's
10 incentive to control storm expenses."

11 **Q. Does the logic that caused the Commission to accept Rider SMP/AMP for the**
12 **limited purpose of recovering capitalized costs associated with the AMI Pilot,**
13 **but reject Rider SEA storm restoration expense tracking, also support**
14 **rejection of ComEd's proposed expansion of Rider SMP/AMP to now recover**
15 **expensed costs?**

16 A. Yes. The expensed costs expected to be incurred by ComEd in connection with the
17 AMI Pilot and related Customer Applications work are not of sufficient magnitude
18 or volatility to justify rider recovery. In total, these expensed costs are estimated at
19 approximately \$21.5 million, of which the Company proposes to include \$12.6
20 million related to "Customer Applications and Public Information and Community
21 Outreach" costs for recovery through Rider AMP.⁶ These amounts are less than

⁶ ComEd Ex. 5.0, line 171.

1 two percent of the total O&M expenses approved for ComEd in the last rate Order.⁷
2 The \$12.6 million of proposed AMI Customer Applications related costs is also far
3 less than the fluctuating storm expenses of up to \$61.3 million that ComEd sought
4 to include in Rider SEA that was rejected by the Commission in Docket No. 07-
5 0566.⁸ In my opinion, the AMI Pilot Program Customer Applications expenses that
6 are now proposed for special accelerated recovery through Rider AMP are not
7 sufficiently large or volatile to merit inclusion in Rider AMP.

8 **Q. Will ComEd be able to proceed with its planned AMI Pilot and customer**
9 **applications efforts if the Rider AMP expansion is denied?**

10 A. Yes. The Company clearly has the financial resources to proceed with AMI Pilot
11 related work, as discussed further in Part III of my testimony below. While
12 ComEd's preference is undoubtedly to charge ratepayer more for such work
13 through expansion of the Rider AMP provisions, the Commission should insist
14 upon the Company doing all approved work in this area without exceptional Rider
15 surcharging of the piecemeal costs to the disadvantage of ratepayers.

16

17

⁷ Docket No. 07-0566, Final Order, September 10, 2008, Appendix, page 1 shows total Operating Expense Before Income Taxes of \$1,333 million. \$12.6 represents only 0.9% of this amount. \$21.5 million represents 1.6% of this amount.

⁸ *Id.* Page 155.

1 **III. NO FINANCIAL NEED EXISTS FOR AMI EXPENSE TRACKING**

2 **Q. How does ComEd explain and attempt to justify its proposed expansion of**
3 **Rider AMP to include operating expenses in addition to the capitalized costs**
4 **already approved by the Commission?**

5 A. At page 19 of his testimony, Dr. Hemphill states:

6 First and foremost, ComEd proposes to revise Rider AMP to
7 enable ComEd to pilot AMI customer applications as well as the
8 AMI technologies themselves. It makes sense to study customers'
9 applications at the same time as ComEd is piloting AMI
10 technology not only to avoid duplication of effort, but also because
11 these applications hold out the promise of important customer
12 benefits[footnote omitted]. However, piloting these applications
13 will cause ComEd to incur material additional operating expenses,
14 expenses that would not be recovered through Rider AMP as
15 presently written nor recovered under other current rates.
16 Moreover, the benefits customers receive from these applications
17 do not reduce ComEd's own costs or contribute to ComEd's ability
18 to fund the pilot. Therefore, ComEd is proposing to revise Rider
19 AMP to provide for recovery of the operating costs of these
20 customers applications under an approach that mirrors that
21 previously approved by the Commission for the technological
22 aspects of the pilot.

23
24 Thus, ComEd seems to suggest that it cannot or will not proceed with the
25 AMI Pilot and related customer applications assessment without an
26 expansion of Rider AMP to include expensed costs.

27 **Q. Is it necessary to expand Rider AMP for expense recovery in order to**
28 **“enable” ComEd to proceed with the pilot?**

29 A. No. ComEd could decide to use available financial resources, at present rate
30 and revenue levels, to incur the expected expenses associated with the
31 planned AMI pilot and customer applications activities. What the Company

1 clearly hopes to accomplish, rather than being satisfied with traditional cost
2 recovery, is gaining additional piecemeal rate relief outside of any formal
3 rate case through the proposed expansion of Rider AMP.

4 **Q. Is there evidence to suggest that ComEd expects to be able to reduce its**
5 **expenses in amounts that exceed the anticipated AMI Pilot and Customer**
6 **Applications study costs that must be expensed, rather than capitalized?**

7 A. Yes. As part of Exelon's Earnings Conference Call - 1st Quarter 2009 presentation
8 graphics dated April 23, 2009, the investing public was informed of an anticipated
9 \$50 million reduction in ComEd's total expenses from \$1,100 million in actual
10 expense in 2008, compared to reduced \$1,050 in projected 2009 expenses. This
11 single year expectation of \$50 million in expense savings of illustrates how dynamic
12 overall expenses levels can be – and how important it is for the Commission to
13 consider expense changes in the aggregate within overall rate case proceedings,
14 rather than through piecemeal tracking of isolated costs.

15 In the same slide, ComEd presents estimated reduced Capital Expenditures
16 declining from \$950 million in actual spending in 2008 to a projected level of \$875
17 million in 2009. These projections are part of Exelon's overall message regarding
18 "Cost and Capital Management" and "Driving productivity and cost reduction while
19 maintaining superior operations." I have included relevant pages from this
20 information on the Company's web site as AG/AARP Exhibit 1.3.

21 **Q. At page 30 of ComEd Exhibit 4.0, the Direct Panel Testimony of Ms. Jensen**
22 **and Mr. Eber presents a Table 5 summarizing the \$12.6 million of "Total**

1 **O&M” expenses that would be charged to ratepayers if the expansion of Rider**
2 **AMP is approved. Are these estimated costs so large or unusual as to merit**
3 **special tariff recovery on a piecemeal basis?**

4 A. No. The single largest expensed cost shown is for “Software (developed or
5 licensed)” in the projected amount of \$3.6 million. Expenses associated with
6 software development and licensing are part of the normal and routine expenses
7 involved in operation of any large utility. The specific types of expensed software
8 can be expected to vary from year to year as development projects shift from
9 system to system, but some significant amount of expensed software cost is a
10 normal part of utility operations and was undoubtedly included in the Company’s
11 last rate case proceeding. The second largest estimated expense element is for \$2.2
12 million of “Public Information – Community Outreach” that is also, in varying
13 amounts, a part of routine utility expenses incurred to distribute information to
14 customers and to maintain local community programs and presence. Again, ComEd
15 has shown no need for extraordinary tariff rider recovery of these types of costs.

16 **Q. Will ComEd be able, under present rates, to recover its AMI Customer**
17 **Applications expenses?**

18 A. Yes. ComEd’s rates appear to be adequate to meet its normal, overall level of
19 expenses. If this were not true, the Company could be expected to seek rate relief
20 through a rate case proceeding. Moreover, given the Company’s announced plans
21 to reduce both its expenses and capital expenditure levels in 2009, ComEd has the
22 ability and intent to manage its costs to achieve reasonable financial results without

1 initiating formal rate proceedings. The Company has made no showing of a need
2 for rate relief due to any inadequacy of overall revenues to meet its overall costs.

3 **Q. Are the proposed modifications to existing Rider AMP, as shown at**
4 **Attachment 2 to the Verified Petition in legislative format, likely to be difficult**
5 **to regulate if approved by the Commission?**

6 A. Yes. The second page of Attachment 2 proposes to add a definition for “Authorized
7 Incremental Costs” using terms and criteria that are vague and will be very difficult
8 to enforce. For example, such new incremental expenses would include, “wages,
9 salaries and benefits of Company employees...who are hired for positions that are
10 specifically related to Customer Applications.” By this definition, ComEd would be
11 free to hire new information technology personnel and assign them some work on
12 qualifying AMI-related IT projects in order to achieve piecemeal rate recovery of
13 the new employee’s salary and benefit costs at the same time other staffing
14 reductions may occur to produce expenses savings that are ignored under Rider
15 SMP/AMP. Similarly, the proposed revisions to the rider would permit piecemeal
16 recovery of advertising expenses for “dissemination of information to and education
17 of retail customers regarding the AMP”, even if advertising containing other
18 messages has been reduced or eliminated to reduce overall expenses. These types of
19 vague definitions make it difficult to effectively monitor and regulate rider recovery
20 of selectively defined utility expenses, because of the potential for profitable gaming
21 by the utility of the new opportunities presented in Rider AMP to achieve piecemeal
22 rate increases outside of full rate cases.

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~~IV. RIDER AMP EXPANSION FOR STIMULUS PROJECTS~~

~~Q. What is proposed by ComEd with regard to modification of Rider AMI for federal stimulus funds?~~

~~A. According to Dr. Hemphill's Direct Testimony, opportunities are available for utilities like ComEd to obtain and use federal stimulus funds for smart grid projects, including AMI applications. He argues that because of the short review cycles expected to be applied to funding proposals from utilities seeking to use such funds, "... it is critical for the Commission and ComEd to be able to respond nimbly, and ComEd proposes to add a mechanism to Rider AMP to allow the Commission to review, approve, and implement stimulus-funded programs should appropriate opportunities arise."⁹~~

~~Q. Is a short review cycle a good reason to expedite regulatory review and increased charging to ratepayers?~~

~~A. No. This is probably the worst reason to grant expedited regulatory approval and rate increases. The responsibility of utility management to carefully evaluate the prudence and cost-effectiveness of specific new projects is not eliminated when federal government subsidies are introduced into the analysis. Stimulus funding from the federal government can be expected to improve the economics for an otherwise marginally reasonable utility technology project, but this does not ensure that the project is prudent or reasonable. The availability of such funding should~~

⁹ ComEd Ex. 1.0 at lines 41-44.

1 also not lower regulatory expectations for responsible management screening,
2 project analysis and the “nimble” response said to be needed by ComEd to secure
3 such funding.

4 ~~—————~~ In my opinion, forcing regulators to expeditiously review and approve
5 complex technology spending projects, where regulators do not possess the
6 requisite specialized employee skills and experience or the specialized consulting
7 resources that ComEd controls, ensures either an inadequately detailed analysis by
8 the regulator with uninformed approvals of stimulus projects or a comprehensive
9 regulatory review involving assignment of Staff resources and the retention of Staff
10 consultants that would be far from “nimble”.

11 **~~Q. ———~~ The proposed revisions to Rider AMP would add language at 1st Revised Sheet**
12 **~~No. 226 that indicates Commission approval, “...does not constitute approval~~**
13 **~~of the reasonableness of the actual expense amounts, and such actual expense~~**
14 **~~amounts may be reviewed for reasonableness and adjusted in the~~**
15 **~~reconciliation process following the occurrence of such expenses.” Does this~~**
16 **~~provision for after the fact review and potential disallowance of any~~**
17 **~~unreasonable costs resolve the problem you raise regarding expedited~~**
18 **~~regulatory review?~~**

19 **~~A. ———~~ No. This language is similar to the existing language in Rider AMP that**
20 **~~theoretically enables regulatory disallowances of unreasonable capitalized cost~~**
21 **~~recoveries in the reconciliation process. The annual reconciliation process is~~**
22 **~~described at Sheet No. 235 of the Rider AMP tariff and would provide~~**

1 ~~“informational” filings from the Company verifying the accuracy of computed~~
2 ~~charges, while offering little opportunity for substantive prudence review for the~~
3 ~~underlying complex technology projects. The annual reconciliation report filings~~
4 ~~are not required to provide any economic justification for project spending or~~
5 ~~explanations for any cost over-runs relative to planned spending and there is no~~
6 ~~established process for funding consulting resources to assist Staff in the review of~~
7 ~~such annual reconciliation filings. This process is a poor substitute for the more~~
8 ~~rigorous review that can be undertaken by concerned parties in formal rate~~
9 ~~proceedings if imprudently incurred utility costs are suspected, where time and~~
10 ~~resources can be secured for critical formal discovery and analysis of technology~~
11 ~~spending that has occurred.~~

12 ~~Q. At lines 123-124 of his Direct Testimony, Dr. Hemphill states that ComEd is~~
13 ~~asking the Commission to “(a)dopt revisions to Rider AMP to optimize~~
14 ~~ComEd’s ability to secure and use federal stimulus funds for Commission-~~
15 ~~approved projects.” Are you aware of any Commission approvals that are~~
16 ~~required by the federal government before ComEd can qualify for stimulus~~
17 ~~funding for its smart grid or other planned technology spending?~~

18 ~~A. I am not an attorney and can offer no legal opinion on this matter. In Data Request~~
19 ~~No. AG (MLB) 2.04, the Company was asked about this testimony passage and did~~
20 ~~not identify any specific approval requirements that are needed from the ICC to~~
21 ~~apply for or receive federal stimulus funding. Instead, the Company argues in its~~
22 ~~response that, “As a practical matter, any project that would cause ComEd to incur~~

1 ~~material unfunded costs would require Commission approval of a cost recovery~~
2 ~~mechanism.” I have provided a complete copy of this Data Request Response as~~
3 ~~AG/AARP Exhibit No. 1.4.~~

4 **Q. Regarding ComEd’s argument about “unfunded costs”, do existing utility rate**
5 **revenues provide funding for new technology projects that ComEd**
6 **management may elect to pursue?**

7 A. Yes. It is misleading to imply that new capitalized or expensed projects undertaken
8 by ComEd are “unfunded” until they are specifically included in a rate proceeding
9 or piecemeal rider mechanism. Existing utility rates and revenues include an
10 ongoing O&M expense level and depreciation recoveries of existing plant
11 investments that provides internally generated funds contemplating that ComEd will
12 continuously re-invest in its business. In Docket No. 07-0566, the Appendix to the
13 Commission’s September 10, 2008 Order indicates that approved annual
14 “Depreciation and Amortization” expense recoveries of about \$155 million per year
15 will be available as internally generated funding for technology and other projects.
16 Total approved pre-tax Operating Expenses inclusive of such Depreciation and
17 Amortization exceeded \$1.3 billion annually. Before ComEd can call its ongoing
18 re-investment in its business “unfunded”, it would need to account for this
19 substantial annual funding that is being provided by ratepayers. The normal course
20 of business is for the utility’s management to be held fully responsibility to evaluate
21 how to cost-effectively apply new technology and financial resources to the
22 business to provide utility services at the lowest practical cost, then filing rate case

1 proceedings if and when existing annual revenues can be proved to be insufficient
2 to recover the total of prudently incurred costs incurred to provide service.

3 ~~Q. Does ComEd project that its Cash Flow from Operations will significantly~~
4 ~~exceed its estimated Capital Expenditures in 2009?~~

5 ~~A. Yes. The “2009 Projected Sources and Uses of Cash” contained at page 3 of the~~
6 ~~Exelon Earnings Conference Call * 1st Quarter 2009 document in AG/AARP~~
7 ~~Exhibit 1.3 indicates projected ComEd Cash Flow from Operations of \$1,250~~
8 ~~million will significantly exceed total projected Capital Expenditures of \$875~~
9 ~~million. Thus, ComEd’s utility operations are expected to produce strong cash~~
10 ~~flows to support new capital investment while supporting dividends to the Exelon~~
11 ~~parent entity. This is another indication that ComEd has no financial need for~~
12 ~~additional Rider SMP/AMP piecemeal rate relief beyond the levels already~~
13 ~~approved by the Commission to support the Pilot. The large internally generated~~
14 ~~ComEd Cash Flows from Operations represent substantial funding capability for~~
15 ~~any federal stimulus projects utility management elects to pursue.~~

16 ~~Q. At line 452 of his Direct Testimony, Dr. Hemphill states, “Therefore, ComEd is~~
17 ~~proposing to add ‘enabling’ language to Rider AMP that would permit it to~~
18 ~~propose projects to the Commission for approval if those projects were funded~~
19 ~~in hole, or on a matching basis, by federal stimulus funds.” Is ComEd able,~~
20 ~~without such “enabling” language, to pursue available federal stimulus funds?~~

21 ~~A. Yes. In Data Request No. AG (MLB) 2.08 the Company responded to the question,~~
22 ~~“Is it Mr. Hemphill’s understanding that federal stimulus fund availability is~~

1 contingent upon Illinois Commission approval of projects” with the statement, “No.
2 Dr. Hemphill does not so state.” Part (a) of this response indicates that, “Advance
3 approval allows the Commission to regulate these investments before they are
4 made, reducing legal, financial, regulatory, and stranded cost risks.” A complete
5 copy of this response is provided with this testimony as AG/AARP Exhibit 1.5.

6 ~~Q. Do you agree with ComEd that “Advance approval by the Commission reduces~~
7 ~~legal, financial, regulatory and stranded cost risks”?~~

8 ~~A. No. Imposing upon the Commission an obligation to review and approve complex~~
9 ~~technology projects in advance of spending only reduces such risks from the limited~~
10 ~~perspective of utility investors, and then does so only by transferring the risks to~~
11 ~~ratepayers. The risks associated with evaluation and deployment of complex~~
12 ~~technologies are most appropriately managed by the utility and not its regulators~~
13 ~~and customers. To state the obvious, the utility employs the skilled personnel~~
14 ~~having detailed experience with existing systems and business needs as well as the~~
15 ~~resources to solicit and retain consulting expertise where employee skills must be~~
16 ~~supplemented. The utility should retain the responsibility to perform the investment~~
17 ~~cost/benefit analysis and business case development using these internal resources,~~
18 ~~with the regulator examining results after the fact to ensure that actions taken (or~~
19 ~~not taken) by utility management were reasonable.~~

20 ~~Q. Is it reasonable to ask the Commission to review and find prudent complex~~
21 ~~new federal stimulus projects pursuant to Rider AMP, before the utility~~
22 ~~proceeds to make financial commitments to such projects?~~

1 ~~A. No. According to the Company's response to Data Request No. DLH 4.03, "It is~~
2 ~~ComEd's position that by approving a project, the Commission is determining the~~
3 ~~prudence of proceeding with that project, i.e., that it is reasonable for ComEd's~~
4 ~~management, given the information available, to proceed with the proposed~~
5 ~~project." Such an advance prudence determination is not reasonable because the~~
6 ~~Commission would not possess the same detailed information about or~~
7 ~~understanding of a given project's costs, opportunities and risks that utility~~
8 ~~management will possess at that time. This lack of informational symmetry ensures~~
9 ~~that the proposed Commission pre-approval of projects will serve to protect the~~
10 ~~Company's shareholders from future prudence disallowances, but will not protect~~
11 ~~its ratepayers from imprudent outcomes.~~

12 ~~——— In my opinion, ComEd management should be held responsible for~~
13 ~~running its business, for making reasonable determinations in customers' interest,~~
14 ~~for developing and analyzing the business cases for its investments, and for~~
15 ~~executing its business plans effectively and efficiently, including full responsibility~~
16 ~~for being informed to the extent necessary to accomplish these things. It is~~
17 ~~disingenuous for ComEd to seek to transfer such responsibilities to the Commission~~
18 ~~as part of an advance prudence determination that would obviate such~~
19 ~~responsibilities.~~

20 ~~Q. At line 460, Dr. Hemphill states that, "The amendment of Rider AMP~~
21 ~~empowers not only ComEd, but the Commission, to move forward with~~
22 ~~opportunities to obtain and use federal funds when and if those opportunities~~

1 ~~present themselves.” Does Dr. Hemphill explain how the Commission might~~
2 ~~secure federal funds as implied by this statement?~~

3 A. ~~No. According to its response to Data Request No. AG (MLB) 2.09, “Dr.~~
4 ~~Hemphill’s testimony does not address the Commission’s opportunities to secure~~
5 ~~federal funds under ARRA.” This response does not explain any reasons why~~
6 ~~Illinois utilities would not or could not pursue federal stimulus or other funds~~
7 ~~without special rider treatment of the project costs, beyond a general reference to~~
8 ~~the responses to other AG Data Requests provided as Exhibits to my testimony. I~~
9 ~~have included a complete copy of ComEd’s objections and response Data Request~~
10 ~~No. AG (MLB) 2.09 as AG/AARP Exhibit 1.6.~~

11 **Q. At lines 881-887 of his Direct Testimony, Dr. Hemphill asserts that the changes**
12 **being proposed to expand Rider AMP cannot harm customers because,**
13 **“...Rider AMP includes Commission-approved protections against over-**
14 **earning that would remain in place.” What are the “protections” that are**
15 **being referenced in this testimony?**

16 A. According to the Company’s response to Data Request No. AG (MLB) 2.10, “Dr.
17 Hemphill intended to refer to (1) the earnings cap in Rider AMP; and (2) the
18 Commission’s authority to investigate ComEd’s rates should it over-earn.” I have
19 included a complete copy of this document as AG/AARP Exhibit 1.7.

20 **Q. Does the earnings cap in Rider AMP provide any meaningful protection for**
21 **ratepayers in its present form?**

1 A. No. Rider AMP 1st Revised Sheet No. 225 defines how Net Operating Income and
2 Rate Base are to be calculated to determine a Return on Rate Base, for use in
3 calculating refunds of any AMP adjustments that contributed to returns in excess of
4 authorized levels.¹⁰ However, it is not possible to prescribe the calculation of Net
5 Operating Income or Rate Base with sufficient precision to ensure no excess
6 earnings will occur. The actual determination of ratemaking operating income and
7 rate base are complex undertakings that require analysis and adjustment of the
8 unique transactions recorded in a particular test year. Rider AMP does not provide
9 for such an analysis or for any review process to provide for alternative views of
10 what adjustments should be made. Indeed, if such a summarized prescription of
11 these terms were possible in lieu of formal rate case processes, it would not be
12 necessary for the detailed rate case filings, discovery procedures, analysis by the
13 parties and testimony regarding revenues, expenses and rate base to be considered
14 by the Commission in order to determine just and reasonable utility rates. In my
15 opinion, the earnings cap in Rider AMP provides no meaningful assurance that the
16 resulting incremental revenues will not contribute to excessive utility rates.

17 **Q. Did the Commission observe that the earnings cap in Rider AMP was a less**
18 **than perfect remedy for potential excessive recoveries of costs under the**
19 **Rider?**

20 A. Yes. At page 138 of its Order in Docket No. 07-0566, the Commission states, “The
21 lack of a consistent, thorough and analytic approach to estimating benefits simply

¹⁰ ~~Rider AMP 1st Revised Sheet No. 235 explains the refund provisions regarding excessive return~~

1 highlights another shortcoming: ComEd is asking for special recovery for these
2 projects that – whatever their level, all parties agree – could have long-term
3 economic benefits, but as proposed, ratepayers do not share the economic benefits.
4 It is not clear that the earnings cap, with all its potential for disagreement,
5 adequately answers this concern.”
6

7 **V. RECOVERY PERIOD FOR RETIRED METERS**

8 **Q. In its Order in Docket No. 07-0566 approving Rider SMP/AMP for the limited**
9 **purpose of the Phase 0 AMI Pilot, what amortization period was established by**
10 **the Commission for the existing electric meters expected to be prematurely**
11 **retired upon installation of AMI?**

12 A. The Commission declined to find an appropriate amortization period for the un-
13 recovered costs of meters that would be prematurely retired, instead indicating, “At
14 the time that ComEd requests approval of Phase 0, the Commission will address the
15 amortization period for the meters that will be retired.”¹¹

16 **Q. What amortization periods have been proposed for the meters to be retired?**

17 A. In its rate case testimony in Docket No. 07-0566, the Staff recommended an 18-year
18 amortization period. In his Direct Testimony in this Docket No. 09-0263, ComEd
19 witness Mr. Fruehe is advocating an amortization over 10 years, stating his opinion
20 that, “...in my view, a ten year period strikes the appropriate balance of these two
21 interests: it affords ComEd more certainty of recovery and it spreads recovery of

as part of the Annual Reconciliation procedures. See ComEd Petition Attachment 1.

1 costs over a longer period of time thus lessening the impact on customer rates.

2 Additionally, the shorter the amortization period, the lower the likelihood of any
3 inter-generational cost shifting.”¹²

4 **Q. What is your opinion regarding the amortization period to be afforded**
5 **prematurely retired meters?**

6 A. A more reasonable balance than either the Staff or ComEd positions would be to
7 amortization the regulatory asset containing retired meter costs over 13 years, the
8 estimated remaining recovery life for these assets under the Company’s own
9 recently completed depreciation study. Mr. Fruehe states at page 7 of his testimony
10 that the estimated remaining life of the meters being retired is 13.69 years. Any
11 amortization period shorter than 13 years would have the effect of amplifying the
12 cost burden upon ratepayers of the AMI project, relative to current regulation, even
13 though ComEd faces no risk of non-recovery once regulatory asset accounting is
14 granted for these assets.

15 **Q. Is there a large cost impact associated with adoption of a 13-year versus 10-**
16 **year amortization period for the meters that would be retired in the AMI**
17 **Pilot?**

18 A. No. The amounts involved for the AMI Pilot are not large, as indicated by the
19 \$165,242 in estimated quarterly amortization costs shown by Mr. Fruehe in ComEd
20 Ex. 5.01, page 4 in column G, using his proposed 10-year amortization. However, if
21 an amortization period is established now that would later be applied to the much

¹¹ Final Order, September 10, 2008, ICC Docket No. 07-0566, at 140.

1 larger retired meter regulatory asset amounts from future broader deployments of
2 AMI, the cost difference from more rapid amortization could be significant.

3 **Q. Is there another reason why a longer 13 year amortization period would be**
4 **equitable for the prematurely retired meters?**

5 A. Yes. ComEd expects to be able to completely retire the meters that are removed as
6 an ordinary loss for income tax deduction purposes, creating large immediate
7 income tax deductions and tax savings benefits for its shareholders. According to
8 ComEd's response to Data Request No. AG (MLB) 2.02, the estimated income tax
9 deductions resulting from such retirement losses will exceed \$3.4 million by the
10 second quarter of 2010.¹³ Yet, the retired meters would remain in rate base until
11 such costs were explicitly removed in a next rate case,¹⁴ at the same time the cash
12 flow benefits from immediate income tax deductions were retained for
13 shareholders. The longer amortization period I recommend provides equitable
14 consideration for the meter retirement tax deduction cash flow benefits that ComEd
15 would not immediately share with its ratepayers under Rider AMP. I have included
16 as AG/AARP Exhibit 1.8 a copy of ComEd's response to Data Request AG (MLB)
17 2.02, wherein these deferred tax amounts are developed.

18 **Q. At page 6, Mr. Fruehe references FAS 92, an accounting pronouncement**
19 **applicable to Accounting for Regulated Enterprises Phase-in Plans, which he**
20 **characterizes as "the most relevant guidance that is generally applicable to**

¹² ComEd Ex. 5.0, lines 105-118.

¹³ ComEd Response to Data Request No AG (MLB) 2.02, parts a and b.

¹⁴ ComEd Ex. 5.0, lines 148-151.

1 **other types of regulatory cost deferrals.”¹⁵ Does FAS 92 provide any support**
2 **for the Company’s proposed 10-year amortization of retired meter costs?**

3 A. No. The meter costs in question are not associated with any phase-in plan and need
4 not be tailored to FAS 92 requirements. Mr. Fruehe admits that this pronouncement
5 is “not directly applicable” and has offered no indication as to how phase-in plans
6 are even remotely analogous to prematurely retired meters.¹⁶ If ComEd were
7 offering to phase-in the capitalized costs of its AMI investment more slowly than
8 would be required under traditional rate base regulation, FAS 92 requirements
9 might be applicable. However, this Docket involves the opposite situation, where
10 Rider AMP would provide ComEd even more rapid cost recovery than can be
11 achieved under the traditional regulatory model.

12 **Q. Please summarize your conclusions regarding ComEd’s various Rider AMP**
13 **related proposals in this Docket.**

14 A. ComEd has not shown any basis or need for the proposed expansions to Rider AMP
15 that would, if approved, unreasonably shift costs and risks associated with AMI
16 customer applications testing and unspecified future federal stimulus projects to
17 ratepayers. My testimony explains why the present scope of Rider AMP, as
18 approved by the Commission in Docket No. 07-0566, is designed to provide
19 compensation to ComEd for the capital investment associated with the AMI Pilot
20 work, while anticipated expense savings and existing cash flows from the business
21 are adequate to recover ongoing expenses without expanding Rider AMP. Finally, I

¹⁵ ComEd Ex. 5.0, lines 125-129.

1 recommend that the recovery period for prematurely retired meters be no less than
2 13 years.

3 **Q.** **Does this conclude your testimony at this time?**

4 **A.** Yes.

¹⁶ *Id.* lines 120-123.