Docket No. 10-0138
ICC Staff Exhibit 4.0

DIRECT TESTIMONY

of

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Illinois Commerce Commission

Commonwealth Edison Company

Proposal to Establish Rider PORCB
(Purchase of Receivables with Consolidated Billing)

Docket No. 10-0138

June 10, 2010

1. Q. Please state your name and business address.

A. My name is Rochelle Phipps. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

2. Q. By whom are you employed and in what capacity?

A. I am currently employed as a Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Illinois Commerce Commission ("Commission").

3. Q. Please describe your qualifications and background.

A. I received a Bachelor of Arts degree in Finance from Illinois College, Jacksonville, Illinois. I received a Master of Business Administration degree from the University of Illinois at Springfield. I have been employed by the Commission since June 2000.

4. Q. What is the purpose of your testimony in this proceeding?

A. Commonwealth Edison Company ("ComEd" or "Company") proposes to implement a Purchase Of Receivables and Consolidated Billing program ("PORCB program") pursuant to Section 16-118 of the Illinois Public Utilities Act ("Act"). The Company proposes to recover prudently incurred capital costs associated with implementing the PORCB program through a new Rider PORCB - Purchase of Receivables with Consolidated Billing ("Rider PORCB") and tariff revisions to Rider RCA – Retail Customer

Assessments ("Rider RCA").[1] The Company proposes to apply a carrying charge that equals the Commission-authorized rate of return on rate base to the unrecovered PORCB costs (*i.e.*, the PORCB assets).[2] I will present my evaluation of the Company's rate of return proposal and my rate of return recommendation for the PORCB assets.

5. Q. Please summarize your conclusions and recommendations.

A. The Company's proposed rate of return equals the cost of capital for electric delivery services, which implies that the risk inherent in the recovery of PORCB assets equals the risk of the Company's electric delivery services assets. In my judgment, the PORCB assets warrant a lower rate of return than electric delivery services. Specifically, I recommend applying a 6.61% rate of return on common equity to PORCB assets, which results in an overall rate of return of 6.71%. My cost of equity estimate equals the midpoint of the ten-year yield on AAA-rated utility debt and the Company's rate of return on rate base, as adjusted to reflect a ten-year maturity instead of a perpetuity.

6. Q. Please describe the key characteristics that distinguish the risk inherent in the recovery of PORCB assets from those inherent in the investment in traditionally rate-based assets.

[1] ComEd Ex. 1.1 and ComEd Ex. 1.2.
[2] ComEd Ex. 1.1, Original Sheet No. 397.

A. The Company's electric delivery services rates are based on a Commission-authorized revenue requirement, which includes a targeted, fair return on unrecovered investment. Nevertheless, the return on unrecovered investment is not guaranteed. The utility could earn more or less than the targeted, fair return on investment depending upon the degree to which its actual revenues, expenses and investment differ from the levels composing its revenue requirement.

In contrast, the Company's proposed Rider PORCB and Rider RCA will provide "dollar-for-dollar cost recovery."[3] Towards that end, Rider RCA includes components that would capture differences (either positive or negative) between and actual and projected recovery of PORCB costs.[4] That "true-up" reduces risk associated with the PORCB assets relative to cost recovery through traditional rates. The rate of return investors require varies with risk; therefore, the PORCB assets require a lower rate of return than rate base assets.

7. Q. Did the Company analyze the risk associated with recovering the cost of PORCB assets though a rider with a true-up mechanism relative to the risk of cost recovery through tariffs established in a rate case?

[3] ComEd Ex. 1.0, p. 10.
[4] ComEd Ex. 1.2, Original Sheet Nos. 257 through 257.3.

A. No. ComEd has not performed such analyses.[5]

8. Q. Please describe the similarities between the PORCB assets and cost recovery for securitized utility debt obligations, such as ComEd's AAA-rated transitional funding instruments,[6] which the Commission authorized in Docket No. 98-0319 ("Securitization").[7]

A. Several important features of the Company's PORCB assets resemble Securitization.[8] Foremost, the Statutes authorizing the PORCB program (Public Act 95-0700) and Securitization (Public Act 90-0561) explicitly require recovery of program costs by utilities. Specifically, Section 18-104 of the Act ("Terms and Provisions of Transitional Funding Order") authorizes the Commission to create and establish "intangible transition property," which secures the right to collect transitional funding charges outside of the traditional revenue-requirement construct for one or more legislatively mandated purposes.[9] Further, Section 18-103 of the Act requires the Commission to approve the issuance transitional funding instruments in an order.[10] Intangible transition property has four major implications with respect to determining the appropriate rate of return for the PORCB assets.

[5] Company response to ICC Staff data request RP 1.10.
[6] Commonwealth Edison Company, Form 10-K for the fiscal year ended December 31, 2007, p. 145.
[7] Order, Docket No. 98-0319, July 21, 1998.
[8] Generally, securitization provides a means by which a utility could recover costs that were incorporated in the traditional regulatory cost-plus scheme that cannot be passed on to customers in a competitive marketplace. *See* Standard & Poor's, "Research: Securitizing Stranded Costs," January 18, 2001.
[9] 220 ILCS 5/18-104(a).
[10] 220 ILCS 5/18-103(d).

First, by creating a separate asset class, intangible transition property, and permitting the issuance of intangible funding instruments against the value of that asset, the Act implicitly recognized that utility assets that have different levels of risk warrant different rates of return. Absent differences among the opportunity costs of capital of utility assets, creating intangible transition property would have been pointless.

Second, intangible transition property permits the utility to collect charges outside revenue requirement-based rates. Similarly, the Company will recover PORCB assets through Rider PORCB and Rider RCA instead of the Company's revenue requirement-based rates. The Company proposes recovering the costs incurred to provide services related to retail electric suppliers ("RES") from eligible retail customers through Rider RCA to the extent the Company does not initially recover those costs through Rider PORCB.[11]

Third, the discount rate formula would effectively allow the Company to recover from RES an amount above the portion of the PORCB assets that the Company initially assigns to RES.[12] Including a balance factor in the discount rate calculation is similar to establishing cash and over-collateralization reserves, which were credit-enhancing features of Securitization.

[11] ComEd Ex. 1.0, p. 8; ComEd Ex. 1.1, Original Sheet No. 393; and ComEd Ex. 1.2, 1st Revised Sheet No. 257 and Original Sheet No. 257.2.
[12] ComEd Ex. 1.0, p. 20; and ComEd Ex. 1.2, 1st Revised Sheet No. 257 and Original Sheet No. 257.2.

Finally, the Act provided for periodic adjustments to the instrument funding charges to ensure repayment of the transitional funding instruments.[13] Both the PORCB program and Securitization involve periodic reconciliations, which allow updates to Rider PORCB and Rider RCA to capture any variance between the estimates used to establish the program charges and the actual program costs and revenues collected via Rider PORCB and Rider RCA.[14]

9. Q. Are there any risk factors associated with PORCB assets that would warrant a higher risk premium in its investor-required rate of return than Securitization?

A. Yes. If the Commission adopts Staff's recommendation to include language requiring a prudence review of PORCB implementation and start-up costs during the reconciliation proceedings, then such risk of disallowance would warrant a higher risk premium than Securitization. This additional risk factor is reflected in my rate of return recommendation; however, if the Commission rejects Staff's proposed language requiring a prudence review, then I would recommend a 4.23% rate of return on PORCB assets, which equals the current yield for 10-year, AAA-rated utility bonds.[15]

[13] 220 ILCS 5/18-104(d).
[14] ComEd Ex. 1.0, p. 25; ComEd Ex. 1.1, Original Sheet No. 399; and ComEd Ex. 1.2, Original Sheet Nos. 257.1 and 257.3.
[15] Citi, "Bond Market Roundup," June 4, 2010, p. 15.

10. Q. What is your recommendation for the cost of common equity for PORCB assets?

A. I recommend a 6.61% rate of return on common equity for PORCB assets. This represents a 369 basis point adjustment from the base cost of equity the Commission authorized in the Company's last rate case. Here is a table presenting my rate of return recommendation for PORCB assets:

Staff's Rate of Return Recommendation for PORCB Assets

Capital Component	Cost	Weight	Weighted Cost
Debt	6.78%	54.96%	3.73%
Equity	6.61%	45.04%	2.98%
Weighted Average Cost of Capital for PORCB Assets =			**6.71%**

11. Q. How did you estimate the investor-required rate return for PORCB assets?

A. The Company's authorized rate of return on rate base reflects the investor-required rate of return on equity into perpetuity. In contrast, the Company's proposal would amortize PORCB assets over ten years. All else equal, assets with different lives have different required rates of return. Currently, 10- and 30-year U.S. Treasury bond yields are 3.38% and 4.29%, respectively, which is a difference of 91 basis points. Currently, the spread of corporate debt yields over U.S. Treasury bond yields increases 40 basis points when moving from 10- year utility bonds to 30-year utility bonds.[16] Therefore, the 10-year recovery period of PORCB costs alone reduces the Company's proposed cost of equity from 10.3% by 131 basis points, or 8.99%. This cost recovery period adjustment does not take into account any risk adjustment, such as that associated with the cost recovery rider's true-up mechanism and "over-collateralization style" mechanism.

Next, I adjusted the Company's authorized rate of return on rate base to reflect a 238 basis point adjustment that equals one-half the spread between the current interest rate for AAA-rated, 10-year utility bonds (4.23%)[17] and the Company's time horizon-adjusted, Commission-authorized cost of common equity (8.99%). As explained previously, rider recovery of PORCB assets effectively eliminates both regulatory lag and the risk of non-recovery of prudent and reasonable costs incurred in implementing the PORCB program. I chose the midpoint between the 4.23% rate of return on AAA-rated, 10-year utility bonds and ComEd's authorized rate of return on common equity, adjusted for a 10-year amortization period, because while it is clear that the risk of PORCB cost recovery falls between those two limits, determining the precise proportion of the difference between the AAA bond yield and the full, time horizon-adjusted cost of common equity that can be attributable to the risk of non-

[16] Currently, 10- and 30-year, BBB-rated utility bond yields includes spreads over U.S. Treasury bonds of 155 basis points and 195 basis points, respectively. *See* Citi, "Bond Market Roundup," June 4, 2010, pp. 14-15.
[17] Citi, "Bond Market Roundup," June 4, 2010, p. 15.

recovery of imprudent or unreasonably incurred costs is not possible. That is, while PORCB assets would not be subject to the risk of non-recovery of prudent and reasonable costs, the prudency and reasonableness of PORCB assets is still subject to periodic reviews. Thus, there remains some degree of risk of non-recovery of costs.

12. Q. Please explain why you did not adjust the Company's cost of debt.

A. The Company states it will fund the PORCB assets through a combination of debt and equity.[18] Estimating the Company's marginal cost of debt would be theoretically superior to using the embedded cost of long-term debt, but would necessitate removing from the Company's ratemaking capital structure the long-term debt used to fund PORCB assets. The PORCB assets are diminutive relative to the size of the Company's rate base assets, which total approximately $6.7 billion.[19] Therefore, I used the Company's embedded cost of long-term debt to calculate the weighted-average cost of capital for PORCB assets, which does not materially affect my recommendation. The Company's embedded cost of long-term debt equals 6.78%;[20] in comparison, I recommend a 6.61% cost of equity for PORCB assets. Given the Company's capital structure for ratemaking purposes, which comprises 45.04% equity and 54.96% debt, the weighted average cost of capital for PORCB assets equals 6.71%.

[18] Company responses to ICC Staff data requests RP 1.02 and1.03.
[19] Company response to ICC Staff data request RP 1.03; Order, Docket No. 07-0566 (9/10/2008), Appendix, p. 1.
[20] Order, Docket No. 07-0566 (9/10/2008), p. 99.

13. Q. What are the effects of applying a carrying charge to unrecovered PORCB assets that equals the Company's rate of return on rate base?

A. Authorizing a rate of return for PORCB assets that exceeds the investor-required rate of return on PORCB assets would not balance the interests of investors and ratepayers. Rather, it would benefit Company shareholders at the expense of eligible customers because the portion of return that exceeds the investor-required rate of return would be collected from eligible customers and passed through to investors. Investors would receive more return than they require given the risk level of the PORCB assets, but eligible customers would receive no benefit from guaranteeing the recovery of prudent and reasonable PORCB costs.

14. Q. Does this question end your prepared direct testimony?

A. Yes.