

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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| COMMONWEALTH EDISON COMPANY | : | |
| | : | |
| | : | 10-0467 |
| Proposed general increase in rates for delivery service. | : | |

INITIAL BRIEF OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS

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INDEX

| | <u>PAGE</u> |
|--|-------------|
| I. INTRODUCTION/STATEMENT OF THE CASE | 1 |
| II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY | |
| III. TEST YEAR | |
| IV. RATE BASE | 4 |
| A. Overview | |
| B. Potentially Uncontested Issues | |
| 1. Plant | |
| a. AMI Pilot Costs (including AMI Meter Dedeployment Uncontested b/t Company and Staff | |
| b. Other | |
| 2. General and Intangible Plant | |
| 3. Functionalization | |
| C. Potentially Contested Issues | 4 |
| 1. Post-Test Year Adjustments | 4 |
| a. <i>Pro Forma</i> Capital Additions | |
| b. Accumulated Provisions for Depreciation and Amortiza- tion Related Provisions for Accumulated Depreciation | 4 |
| c. Accumulated Deferred Income Taxes (ADIT) | 18 |
| 2. Construction Work in Progress | |
| 3. Specific Plant Investments | |
| a. West Loop Project Repair Disallowances | |
| b. Plymouth Court Feeders | |
| c. Underground Cable | |
| d. PORCB Costs | |
| e. Allocation of G&I Plant | |
| f. Other | |
| 4. Cash Working Capital | |
| 5. 2009 Pension Trust Contribution | |
| 6. Capitalized Incentive Compensation | |
| 7. Customer Deposits | |
| 8. Material and Supplies Inventory | |
| 9. Severance Sots - Regulatory Debit | |
| D. Rate Base (Total) | |

| | | |
|-----|---|--|
| V. | OPERATING EXPENSES | |
| A. | Overview | |
| B. | Potentially Uncontested Issues | |
| 1. | 2009 Amortization Adjustment of Existing Regulatory Assets (Staff) | |
| 2. | Outside Professional Services - Jacobs Consultancy (Staff) | |
| 3. | Advertising Expense (Staff) | |
| 4. | Investment Tax Credit Amortization (AG) | |
| C. | Potentially Contested Issues | |
| 1. | Incentive Compensation Cost and Expenses | |
| 2. | Rate Case Expenses | |
| a. | Rate Case Expenses of the Instant Case | |
| b. | Alternative Regulation Case | |
| 3. | Administrative and General (A&G) Expenses | |
| a. | Exelon Way Severance Amortization | |
| b. | Accounts 920-923 | |
| c. | Pension Costs | |
| I. | Recovery of Actuarially-Determined 2010 Pension And OPEB Costs (Uncontested b/t Company and Staff) | |
| ii. | 2005 Pension Funding Cost Recovery | |
| d. | Wages and Salaries <i>Proforma</i> Adjustment | |
| e. | Director Fees and Expenses | |
| f. | Corporate Aircraft Costs | |
| g. | Perquisites and Awards | |
| h. | Severance Expenses | |
| I. | Charitable Contributions | |
| j. | Legal Fees - IRS Dispute | |
| k. | Professional Sporting Activity Expenses | |
| l. | Workforce Expense Reduction | |
| 4. | AMI Pilot Expenses | |
| 5. | New Business Revenue Credit | |
| 6. | Tax Repair Methodology - New IRS Procedures | |
| 7. | Depreciation of Intangible Plant | |
| 8. | Late Repayment Charge Reclassification | |
| 9. | Illinois Electric Distribution Taxes | |
| 10. | Depreciation and Amortization Expenses (Derivative and Direct) | |
| 11. | Regulatory Asset Relating to Tax Liability for Medicare Part D (Uncontested b/t Company and Staff) | |
| 12. | Taxes Other Than Income Taxes (Derivative Adjustments) | |
| 13. | Income Taxes (Derivative Adjustments) | |
| 14. | Photovoltaic Pilot Costs | |
| 15. | Customer Deposits - Interest Expense Component | |

| | | |
|---------------------------------|--|-----------|
| D. | Operating Expenses (Total) | |
| VI. | RATE OF RETURN | 19 |
| A. | Overview | |
| B. | Capital Structure | |
| C. | Cost of Short-Term Debt | |
| D. | Cost of Long-Term Debt (Uncontested) | |
| E. | Cost of Common Equity | 19 |
| F. | Adjustments to Rate of Return | 31 |
| G. | Overall Cost of Capital (Derivative) | |
| VII. | COST OF SERVICE AND ALLOCATION ISSUES | 34 |
| A. | Overview | 34 |
| B. | Potentially Uncontested Issues | |
| C. | Potentially Contested Issues | 41 |
| 1. | Embedded Cost of Service Study Issues | 41 |
| a. | Class Definitions | 41 |
| (i) | Residential Classes | |
| (ii) | Non-Residential Classes | 41 |
| b. | Primary/Secondary Split | 43 |
| (i) | Appropriate Methodology/Compliance with | |
| Docket No. 08-0532 | 43 | |
| (a) | Functional Identification of Costs | 43 |
| (b) | Direct Observation of ComEd Facilities | |
| (c) | Sampling | |
| (d) | Review of Other Utilities' Treatment of | |
| Primary/Secondary Issues | | |
| (ii) | Other Primary/Secondary Split Issues | |
| (a) | 4kV facilities allocation | |
| c. | Investigation of Assets Used to Serve Extra Large Load | |
| Customer Class | | |
| d. | NCP vs. CP | 48 |
| e. | Allocation of Primary Lines and Substations | 48 |
| f. | Functionalization of General and Intangible Plant | |
| g. | Street Lighting | |
| h. | Allocation of Illinois Electricity Distribution Tax | 53 |
| I. | Indirect Uncollectible Costs and Uncollectible Costs | |
| j. | Customer Service Cost Allocation | |
| k. | Other Docket 08-0532 Compliance Issues | |
| l. | Other Issues | |
| D. | Rate Moderation | 57 |

| | | |
|--------------|---|-----------|
| VIII. | RATE DESIGN | 61 |
| A. | Overview | |
| B. | Potentially Uncontested Issues | 61 |
| 1. | High Voltage Rate Design Simplification | 61 |
| 2. | Rate MSPS | |
| 3. | General Terms and Conditions | |
| a. | New Customer with Load That Includes Motors Equal or Greater than Five Horsepower | |
| 4. | Miscellaneous Charges and Fees | |
| 5. | Meter Lease Charges | |
| 6. | Residential Real Time Pricing Program Costs | |
| 7. | Standard Meter Allowances | |
| C. | Potentially Contested Issues | 62 |
| 1. | SFV | |
| 2. | Decoupling | |
| 3. | Class Definitions | 62 |
| a. | Residential Rate Design - Consolidation of Classes | |
| b. | New Primary Voltage Delivery Class vs. Primary Subclass Charges | 62 |
| 4 | Non-Residential | 66 |
| a. | Movement Toward ECOSS Rates | 66 |
| (i) | Extra Large Load and High Voltage Customer Classes | 67 |
| (ii) | Railroad Customer Class | 67 |
| b. | Allocating Secondary Costs Among Customer Classes | |
| c. | Railroad Customers - Utilization of Railroad Customers' Facilities | |
| c. | Dusk to Dawn Street Lighting | |
| 5. | Collection of Illinois Electricity Distribution Tax | 71 |
| 6. | Distribution Loss Factors | 73 |
| 7. | General Terms and Conditions | |
| a. | Residential Service Station (Ownership of Non-Standard Residential Connections) | |
| b. | Limitation of Liability Language | |
| 8. | Rider UF | |
| 9. | Notification Regarding Elimination of Self Generating Customer Group | |
| 10. | Docket 08-0532 Compliance Issues | |
| 11. | Other Issues | |
| IX. | REVENUES | |
| A. | Uncontested Issues - Other Revenues - Rate Relief Payment | |

| | | | |
|------------|-------------------|---|-----------|
| | B. | Miscellaneous Revenues | |
| | C. | Weather Normalization | |
| | D. | Late Payment Charge Revenues | |
| | E. | New Business Revenue Credit | |
| X. | OTHER | | 75 |
| | A. | RES Services Issue | |
| | B. | Uufr | |
| | C. | Updated Distribution Loss Study | 75 |
| | D. | Meters and Meter Reading | |
| | E. | Competitive Retail Market Development Issues | |
| | F. | New Section 9-250 Investigation of ComEd's Electric Rate Design | |
| | G. | Other | |
| XI. | CONCLUSION | | 75 |

INITIAL BRIEF OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS

I. INTRODUCTION/STATEMENT OF THE CASE

The Illinois Industrial Energy Consumers (“IIEC”) participating in this proceeding have addressed a limited set of issues.¹ IIEC has addressed issues relating to Commonwealth Edison Company’s (“ComEd”) post-test year *pro forma* capital additions and the necessary recognition of offsetting increases in accumulated depreciation and accumulated deferred income taxes over the period of such capital additions. IIEC has also addressed the appropriate return on common equity for ComEd, and opposed ComEd’s proposed adder to the authorized return.

For the third time in the last four years, IIEC is compelled to address persistent significant problems in ComEd’s cost of service study/studies (“ECOSS” or “ECOS Study) and in the primary/secondary split (“P/S”) analysis incorporated in its studies. IIEC has identified continuing problems relating to ComEd’s identification and functionalization of distribution system components and to its allocation of the cost of those system components, based on their function, to customers served at primary and secondary voltages. These study defects also violate prior Commission orders. Contrary to recent Commission directives, ComEd’s proposed ECOS Studies continue to allocate costs of transformers used exclusively to serve secondary voltage customers, to primary

¹ The IIEC Companies in this proceeding are Abbott Laboratories, Inc., Corn Products International, Inc., Enbridge Energy, LLP, Exxon Mobil Power & Gas Supply Services, Inc., General Iron Industries, Merchandise Mart, Sterling Steel Company, LLC, and Thermal Chicago. In addition, the University of Illinois is participating as part of the IIEC intervention group. Collectively, they refer to themselves as IIEC.

voltage customers.² In addition, ComEd has not properly allocated single phase primary lines, which are used, almost exclusively, to serve secondary voltage customers. ComEd continues to allocate costs of such lines to primary voltage customers.

ComEd also presented three cost of service studies that incorporate a proposed new non-residential rate class, the Primary Voltage Delivery Class (“PVD”). ComEd labels these ECOS Studies its “preferred exemplar” studies.³ ComEd created this new rate class in an attempt to comply with the Commission’s directive to present voltage differentiated rates within the non-residential classes. IIEC objects to this approach. IIEC proposes instead that ComEd establish primary and secondary subclasses within each of the existing Medium Load (“ML”), Large Load (“LL”), Very Large Load (“VLL”) and Extra Large Load (“ELL”) delivery service rate classes with separate Distribution Facility Charges (“DFC”) for the subclasses. Another set of ComEd’s ECOS Studies, which it labels “alternative exemplar”, contain customer groupings very similar to IIEC’s proposed approach.⁴ However, ComEd’s exemplar studies (preferred and alternative) fail to properly allocate costs between primary and secondary customers.

IIEC recognizes that ComEd has, at the direction of the Commission, used a Coincident Peak

² As will be detailed below, ComEd has presented eight different ECOS Studies, based on different customer groupings and reflecting corrections of errors in multiple rounds of testimony. ComEd recommends the use of a particular version of its ECOS Studies presented its Rebuttal (Heintz, ComEd Ex. 51.1) and Surrebuttal (Heintz, ComEd Ex. 75.1) testimonies. IIEC refer collectively to these studies as the “Proposed ECOS Studies”.

³ These studies were presented in ComEd supplemental (ComEd Ex. 22.1), rebuttal (ComEd Ex. 51.2) and surrebuttal (ComEd. Ex. 75.2).

⁴ These studies were presented in ComEd’s rebuttal. (ComEd Ex. 51.3) and surrebuttal (Heintz, ComEd Ex. 75.3) testimonies.

(“CP”) allocator instead of the customary Non-Coincident Peak (“NCP”) allocator for the allocation of primary lines and substations in its cost of service studies. However, IIEC has respectfully pointed out the deficiencies of the CP allocator for the allocation of those costs. IIEC recommends that the Commission continue its historical use of the NCP allocator for that purpose.

IIEC has modified a version of ComEd’s “preferred exemplar” ECOS Studies (ComEd Ex. 51.2) to be consistent with the Commission’s prior directives (as to primary and secondary allocations). However, IIEC continues the use of the NCP allocator for primary lines and substations.⁵ IIEC recommends the use of its ECOS study to set rates in this case. If the Commission does not use the IIEC study, the Commission should use the “alternative exemplar” study presented as ComEd Exhibit 75.3, modified to recognize that single phase primary lines are used almost exclusively to serve secondary customers, and, assuming the Commission agrees, to continue use of the NCP allocator for primary lines and substations.

Finally, IIEC has recommended that the Commission allocate the cost of the Illinois Electric Distribution Tax (“IEDT”) partly on the basis of plant in service (essentially demand) and partly on energy, to better reflect the actual causes of the tax expense paid by ComEd. The evidence shows that in any particular year, only a small portion of ComEd’s IEDT amounts is a function of the energy delivered by ComEd to its customers. The predominant portion of the tax, paid by ComEd,

⁵ If the Commission determines to use the IIEC cost study, but not the NCP allocator for primary lines and substations, IIEC has provided a working version of its ECOS model to ComEd and Staff and switching from the NCP allocator to the CP allocator would involve a simple modification of the study. (*See*, Stowe, IIEC Ex. 3.0-C at 27:602-619, explaining how he replaced ComEd’s allocator with the NCP allocator).

is largely a function of the amount of invested capital tax paid by ComEd in 1997, which was based on ComEd's plant in service.

In the area of rate design, IIEC proposes that the Commission directive to implement voltage differentiated rates be accomplished by creating primary and secondary subclasses (with separate DFCs) within ComEd's ML, LL, VLL and ELL delivery service rates classes. IIEC also opposes ComEd's proposal to charge the IEDT as a separate line item on customer bills. IIEC recommends that the tax continue to be collected in existing rates through ComEd's current delivery service charges, just as ComEd's other utility operating expenses are collected.

Finally, IIEC accepts the revised distribution loss factors presented in ComEd's surrebuttal testimony.

This initial brief supports the IIEC positions and recommendations described above.

IV. RATE BASE

C. Potentially Contested Issues

1. Post-Test Year Adjustments

b. Accumulated Provisions for Depreciation and Amortization

i. ComEd's Proposed Plant Additions Adjustment Overstates the Rate Base Used to Set Rates in This Case

Pursuant to Section 287.40, ComEd initially proposed to increase its 2009 test year rate by more than \$1 billion, mainly to capture forecasted post-test year plant additions.⁶ (Houtsma, ComEd

⁶ A fraction of ComEd's post-test year adjustment of rate base is attributable to intangible assets. (See, e.g., Houtsma, ComEd Ex. 6.1, Sch. B-2.1, p1 of 2).

Ex. 6.0 at 8:160, 9:186). ComEd proposes that the rate base used to set rates in this case be augmented by the value of plant additions the utility plans to put in service during the 18-month period following the end of its declared test year. Except for relatively minor deductions related to its additions, ComEd's proposed adjustment ignores the decreases to rate base that are certain to occur over the period of its plant additions. ComEd's proposed rate base increase for selected post-test year changes in plant investment accounts for almost 15% of the rate base ComEd asks the Commission to use for setting rates in this case.

ComEd states that "by including these *pro forma* projects, we seek to recover fully and on a timely basis our investments in projects that will be serving customers during the time when the rates will be in effect." (Houtsma, ComEd Ex. 6.0 Rev. at 9-10:189-191). ComEd also asserts that recognizing the post-test year change in accumulated depreciation over the same period, which would reduce the rate setting rate base, "would "frustrate the cost recovery objective" (as ComEd defines it). (*Id.* at 11:212-220).

However, as IIEC witness Michael Gorman explained, under Section 287.40 post-test year increases to plant investment, attributable to additions to plant in service, are not separate or severable from the post-test year decreases in plant investment attributable to the utility's recovery of past investment through depreciation expense (which is recorded as accumulated depreciation). (Gorman, IIEC Ex. 1.0 at 70-73:1550-1610; *Re: Central Illinois Light Company d/b/a/ AmerenCILCO*, Dkt. 09-0306, et al., (Cons.) (2009 *Ameren Cases*), Order on Rehearing, Nov 4, 2010 at 31). The effect of ComEd's one-sided adjustment is to overstate ComEd's historical test year rate base, which in turn will overstate its cost of capital, and the operating results of the test

year. (Gorman, IIEC Ex. 1.0 at 72:1587). Mr. Gorman proposed a corrective adjustment of more than \$582.7 million to recognize contemporaneous post-test year decreases in rate base attributable to the continuing decline in the value of test year plant. (*Id.* at IIEC Ex. 1.20).

ii. *The Proposed Corrections of IIEC, Staff and AG-CUB Appropriately Match Contemporaneous Post Test Year Increases and Decreases to Rate Base*

In accord with the Commission's most recent decisions on post-test year adjustments, and the consistent holding of the Illinois Appellate Court, IIEC and other parties propose that the Commission correct ComEd's post-test year plant additions adjustment to recognize the build-up of the Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes (ADIT) over the period of any approved plant additions. (*See 2009 Ameren Cases*, Final Order, Apr 29, 2010 at 29-31, Order on Rehearing, Nov 4, 2010 at 44-45, 49; *Commonwealth Edison Company v. Ill. Com. Comm'n*, 937 N.E. 2d 685, ("*ComEd Appeal*") 693; Gorman, IIEC Ex. 1.0 at 68:1488-1514; Ebrey, Staff Ex. 1.0 at 13:257-258; Effron, AG-CUB Ex. 2.0 at 8-9:178-186). Based on the period of the plant additions included in ComEd's proposed adjustment, IIEC witness Gorman recommends a \$582.7 million correction to ComEd's proposed adjustment for additions to rate base over a period of 18 months. His correction for increased accumulated depreciation (combined with IIEC's recommended correction for post-test year changes in ADIT) reduces ComEd's revenue requirement by \$70.9 million. (Gorman, IIEC Ex. 1.0 at 71-73).⁷

⁷ The magnitude of the appropriate reduction in rate base due to post-test year depreciation depends mainly on the period of recognized post-test year plant additions. If that period (18 months) is unchanged, Mr. Gorman's corrective adjustment would not be affected by modifications of ComEd's adjustment for plant additions for other reasons. (*See, e.g.*, Ebrey,

The expert witnesses for the Commission Staff and for AG-CUB propose adjustments that are conceptually consistent with Mr. Gorman's corrective adjustment. (Ebrey, Staff Ex. 1.0 at 11:214-218, 13:257-258; Effron, AG/CUB Ex. 2.0 at 8-9:178-186, 12:251-258). The non-utility experts in this case are unanimous in their rejection of ComEd's unbalanced proposal. Because of differences in their investigations of ComEd's proposed post-test year investments, they reached varying conclusions respecting the appropriate period of the adjustments and the required correction. However, their corrective recommendations uniformly require that both post-test year increases to rate base and post-test year decreases to rate base must be measured, and that they must be measured as of a common date. (*Id.*).

iii. ComEd's Proposed One-Sided Adjustment Is Unlawful and Should Be Rejected Or Corrected As IIEC Proposes

Proposed modifications of ComEd's 2009 historical test year data are governed by Section 287.40. That Commission rule provides:

A utility may propose pro forma adjustments (estimated or calculated adjustments made in the same context and format in which the affected information was provided) to the selected historical test year for all **known and measurable** changes in the operating results of the test year. These adjustments shall reflect **changes affecting the ratepayers in plant investment**, operating revenues, expenses, and cost of capital where such changes occurred during the selected historical test year or are **reasonably certain to occur** subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are **determinable**. Attrition or inflation factors shall not be substituted for a specific study of individual capital, revenue, and expense components. Any proposed known and measurable **adjustment** to the test year **shall be individually identified and supported** in the **direct testimony** of the utility.

Staff Ex. 1.0 at 10:202).

Each adjustment shall be submitted according to the standard information requirement schedules prescribed in 83 Ill. Adm. Code 285. (83 Ill. Adm. Code 287.40 (emphasis added)).

The Commission's most recent decisions on this issue and a binding appellate court decision that is directly on point are all contrary to ComEd's position. Yet, the utility persists in proposing to recognize only post-test year increases to rate base for new plant additions, while ignoring contemporaneous decreases to rate base attributable to the continuing depreciation of test year plant in service (and the effect of accumulated deferred income taxes). (Houtsma, ComEd Ex. 6.0 Rev. at 11:212-230). ComEd argues for continued acceptance of an interpretation of Section 287.40 that has been rejected as unlawful both in Commission decisions and in a determinative decision of the Illinois appellate court. (*2009 Ameren Cases*, Final Order, Apr 29, 2010 at 29-31 and Order on Rehearing, Nov 4, 2010 at 44-45; *ComEd Appeal* at 704-705). If any post-test year plant additions are recognized, the Commission must, as a matter of law, also recognize decreases to ComEd's rate base over the same period in determining the rate base used to set rates in this case. (*ComEd Appeal* at 703).

Commission Decisions. Earlier post-test year adjustments that were substantively identical to ComEd's proposal in this case have been expressly rejected by the Commission as impermissible under its post-test year adjustment rule, Section 287.40. The Commission considered and rejected such adjustments in its Final Order of April 29, 2010 in the *2009 Ameren Cases*. The adjustments in that case were modeled on ComEd's adjustment in its 2007 rate case (Dkt. 07-0566), which was an earlier version of ComEd's proposal here. (*2009 Ameren Cases*, Final Order, April 29, 2010 at 9:29-31).

In *2009 Ameren Cases*, the Commission thoroughly examined the appropriateness of adjustments proposed by non-utility parties to account for post-test year changes in accumulated depreciation and ADIT, correcting the utilities' recognition of plant additions alone. Addressing proposed adjustments identical in relevant respects to ComEd's proposal here, the Commission concluded that the one-sided utility adjustment violated both its test year rules and Section 9-211 of the Public Utilities Act ("PUA") (220 ILCS 5/9-211).

This [utility] interpretation results in consistently and unavoidably inflated rate base and an inescapably inaccurate picture of the utility's finances. This reading is also plainly inconsistent with the Commission's treatment of plant investment should the utility adopt a future test year under Section 287.20(b), plainly inconsistent with basic matching principles, and inconsistent with the approach taken in at least six other states.

* * * *

[T]he Commission finds that if a utility has recovered in rates the cost of an asset through depreciation expense, the associated amount of accumulated depreciation should be deducted from rate base. (*2009 Ameren Cases*, Final Order, Apr 29, 2010 at 31).

As to Section 9-211 of the PUA, the Commission concluded:

[S]uch a *pro forma* adjustment is not consistent with any reading of the Commission's test year rules that is also consistent with the limitations of Section 9-211 of the Act. Section 9-211 essentially requires the Commission to ensure that a utility's approved rate base does not exceed the investment value the utility actually uses to provide service. The measure of the amount of investment so dedicated must account for both increases and decreases (over a consistent period) at any point in time. Under Section 9-211, contemporaneous increases and decreases to rate base are not severable items that can be given disparate treatments. (*Id.*, Final Order, Apr 29, 2010 at 31).

The Commission re-examined its decision rejecting the utilities' one-sided plant additions

adjustment on rehearing, and it affirmed its earlier decisions on issues related to such adjustments. (2009 Ameren Cases, Order on Rehearing, Nov 4, 2010 at 44-45).

The Commission's review, in the 2009 Ameren Cases decision, of its even earlier interpretations and applications of Section 287.40 added further support to its conclusions. (See 2009 Ameren Cases, Order on Rehearing, Nov 4, 2010 at 27, 14-15). The history of past Commission decisions demonstrates that the balanced adjustment IIEC proposes is both unexceptional and appropriate. In the periods before and immediately following adoption of 287.40, balanced adjustments that accounted for both plant additions and changes in accumulated depreciation were unremarkable. In fact, the requirement for balanced adjustments was accepted as routine.⁸ (2009 Ameren Cases, Rehearing Order at 27). In cases contemporaneous with the Commission's adoption of Section 287.40, utilities proposed balanced adjustments, parties offered corrective adjustments when required, and the Commission approved adjustments that took account of accumulated depreciation changes -- all without controversy. (See, *Id.* at 13-15, 27). Such applications of Section 287.40 were a continuation of what was common practice under Section 287.40's predecessor rule, which had language nearly identical to that of Section 287.40. (See 2009 Ameren Cases, Order on Rehearing, Nov. 4, 2010 at 13). The Commission's acceptance of contrary proposals in a small number of cases was a historical anomaly. (See, 2009 Ameren Cases, Order,

⁸ As long ago as *Re Inter-State Water Co.*, Dkt 94-0270 (“*Inter-State Water*”, 1995 Ill. PUC LEXIS 283), the Commission recounted its past actions on this issue as having “consistently approved” plant investment adjustments that took account of both plant additions and changes in accumulated depreciation. (See *Inter-State Water*, 1995 Ill. PUC LEXIS 283 at *30).

April 29, 2010 at 31 (stating Commission policy for future filings)).

The Appellate Court's Decision. During the *2009 Ameren Cases* rehearing proceeding, the Illinois Appellate Court completed its review of the Commission's order in ComEd's prior rate case, Dkt. 07-0566, and issued an opinion on the law governing adjustments for post-test year changes in plant investment. In that context, the appellate court reviewed the same issues addressed by the Commission in *2009 Ameren Cases*, as manifested in ComEd's earlier proposal for the same adjustment the utility replicates in this proceeding. (*ComEd Appeal* at 704-705). As to the lawfulness of ComEd's adjustment to historical test year data for post-test year plant additions, the appellate court reached conclusions identical to those of the Commission. Consistency with the PUA, the Commission rules, and test year principles require the corrective adjustment IIEC proposes. That decision was entered and became effective on September 30, 2010. (*PLS Realty Co v. Granite Investment Co.*, 86 Ill. 2d 291, 304-305 (1981); *Long v. City of New Boston*, 91 Ill. 2d 456, 462 (1982).

The court's opinion emphasizes the importance of applicable provisions of the Commission's enabling statute, *viz.*, PUA sections 9-211 and 9-201.

The Act requires the Commission to establish "just and reasonable" rates 220 ILCS 5/9-201 (West 2006). Section 9-211 of the Act provides that a utility's rate base may include "only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers" (Emphasis added.) 220 ILCS 5/9-211 (West 2006). To determine just and reasonable rates, a utility's rate base, operating costs, and revenues are matched over the test year. BPI II, 146 Ill. 2d at 237-38. (*ComEd Appeal* at 703).

* * * *

Section 9-211 essentially requires the Commission to ensure that a utility's approved rate base does not exceed the investment value that the utility actually uses to provide service. The measure of the amount of investment so dedicated must account for both increases and decreases over a consistent period. Under section 9-211, contemporaneous increases and decreases to rate base are not severable items that can be given disparate treatments. (*ComEd Appeal* at 703).

In IIEC's view, the Commission cannot ignore its duty to assure that, even after adjustments for post-test year "changes affecting ratepayers in plant investment," the rate base used "in any its determination of rates or charges" shall include "only the value of such investment" used to provide service. (83 Ill. Adm. Code 287.40; 220 ILS 5/9-211). ComEd's proposal to calculate its rate base by recognizing increases while ignoring contemporaneous decreases is not consistent with that statutory imperative. Indeed, Commission approval of a calculation of rate base value distorted to include investment already returned through depreciation expense would exceed the express limitation on Commission authority imposed by PUA section 9-211.⁹ (220 ILCS 5/9-211).

We conclude that the Commission miscalculated the value of the plant investment by recognizing increases in rate base investment value due to post-test-year additions without recognizing contemporaneous offsetting decreases in the value of that investment attributable to ongoing depreciation. Section 9--211 essentially requires the Commission to ensure that a utility's approved rate base does not exceed the investment value that the utility actually uses to provide service. (*ComEd Appeal* at 703).

ComEd's only explanation for its persistence in an approach definitively declared unlawful

⁹ Section 9-211 provides: "The Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers."

was simply that the utility intended to seek leave to appeal the decision to the state supreme court. (Houtsma, ComEd Ex. 55.0 at 7:133; Jan. 20 Tr. 2356-2357, 2408-2409).¹⁰ Notwithstanding ComEd's curious argument, the Commission is bound by the appellate court's decision. ComEd's petition for leave to appeal does not affect the authority of the appellate court or the effectiveness of its decision. *PSL Realty Co. v. Granite Investment Co.*, 86 Ill. 2d 291, 304-305 (1981); *Long v. City of New Boston*, 91 Ill. 2d 456, 462 (1982).

ComEd's proposed one-sided adjustment must be rejected as a matter of law. If any post-test year plant additions are recognized to increase ComEd's rate base, decreases to ComEd's rate base over the same period must also be recognized in determining the rate base used to set rates in this case.

iv. ComEd Has Not Shown its Proposed Adjustment to Be Just and Reasonable in Any Case

To justify its one-sided adjustment, ComEd points to Commission statements identifying the use of costs representative of the period rates that are in effect as an objective in applying Section 287.40 and to an alleged trend of significant increases to net plant in service. (Houtsma, ComEd Ex. 6.0 Rev. at 11; ComEd Ex. 55.0 at 234). However, the Commission's decisions have considered the identified goal within the bounds of the applicable test year rules. In this case as well, the Commission must operate within the bounds of applicable law. Similarly, trends based on data from outside the test year cannot justify – and the law does not permit – purposeful

¹⁰ On January 25, 2011, ComEd filed a petition for leave to appeal this and other issues with the Illinois Supreme Court.

overstatements of the historical test year rate base.

More to the point, like much of ComEd's testimony, these arguments implicitly ask the Commission to distort its test year rules and principles to protect ComEd from its decision to use a historical test year in this case. With that choice, ComEd knowingly implicated the Commission's historical test year rules (*see* Houtsma, Jan. 20 Tr. 2341-2342), specifically Section 287.40 and its limits on post-test year adjustments. As its proposed *pro forma* adjustments attest, ComEd obviously knew of its future investment plans and any trend of increasing investment that would not be captured in its chosen historical test year. A different choice -- a future test year -- could have avoided the asserted need for post-test year adjustments. Having elected a historical test year for reasons it does not explain,¹¹ ComEd offers no reason why the well-defined rules associated with its chosen litigation strategy should not apply fully to the utility. It is IIEC's view that the Commission cannot lawfully bend the plainly applicable test year rules to shield ComEd from the effects of its test year election.

ComEd's witnesses attempt to substitute other questions for the issue of whether ComEd's proposed adjustment unlawfully inflates its test year rate base. Mr. Guerra suggests that opposition to a portion of ComEd's expansive plant additions adjustment is tantamount to "pretending that ComEd will invest not a dime in its system through next June." (Guerra, ComEd Ex. 25.0 at 3-4:64-66). No party made any such claim. Mr. Fetter implies that ComEd's proposed post-test year plant

¹¹ While ComEd offered an explanation for its choice of 2009 as its historical test year, the utility did not disclose its reasons for selecting a historical test year over a future test year. (*See* Houtsma, ComEd Ex. 6.0 Rev. at 8-9:162-177).

additions adjustment must be accepted to maintain credit analysts' positive assessment of ComEd's regulatory treatment. His suggestion is baseless. As Mr. Gorman pointed out, for any post-test year adjustments, most (if not all) other jurisdictions reflect changes in gross plant in-service and the accumulated depreciation reserve over the same post-test year period. (Gorman, IIEC Ex. 4.0 at 19-20:411-438). Two jurisdictions that match contemporaneous rate base increases and decreases are Missouri and Iowa. Standard & Poor's and RRA's regulatory assessments in both states are stronger than Illinois' assessment. (*Id.*). Clearly, ComEd's one-sided adjustment is not necessary to maintain strong regulatory rankings.

ComEd's principal defense of its Section 287.40 adjustment for post-test year changes in rate base consists of a series of inapt comparisons between various distorted historical test year results, and a ComEd calculation of hypothetical results derived using future test year concepts not available under that rule. Ms. Houtsma begins ComEd's defense of its adjustment with a relevant rate base inquiry: "Couldn't ComEd have avoided this [future investment not reflected in rates] problem by filing a rate case using a future test year instead of an historical test year?" (Houtsma, ComEd Ex. 6.0 Rev. at 12:240-244). Tellingly, she never answers the question. Instead she opines that a future test year might not yield lower rates than ComEd is requesting here. (*Id.*). She then extends her comparisons to juxtapose ComEd's historical test year revenue requirement (albeit distorted) with a hypothetical future test year revenue requirement. (Houtsma, ComEd Ex. 6.3). Even if rate base were the only factor affecting revenue requirement – and it is not – her comparison still would not be relevant to a determination of the lawfulness or reasonableness of ComEd's test year rate base adjustments. The appropriate standard for that determination is established by the requirements of

Section 287.40 and PUA section 9-211, not an amount derived using future test year concepts like budget-based investment forecasts.

ComEd also compares achieved returns to argue an irrelevant point – that rates, and therefore rate base, were not overstated in ComEd’s *last* rate case. “ComEd’s actual earned return on equity has significantly lagged the ROE authorized by the ICC in rate proceedings, despite the fact that the rate orders in effect for those years included *pro forma* additions without a roll forward of depreciation on embedded plant.” (Houtsma, ComEd Ex. 29.0 at 8-9:160-165). ComEd then leaps to the conclusion that its evaluation of earnings after ComEd’s last rate case “refutes any contention that a failure to update the depreciation reserve would result in overstated rates.” (*Id.*). Aside from the irrelevance of that issue to setting rates in this proceeding, there is no logic in ComEd’s assertion. Rate base is only one of many variables that affect ComEd’s earnings.

Ms. Houtsma’s evidence respecting ComEd’s rate base consists of (a) another comparison of historical test year results to data derived using future test year concepts and (b) an unsupported prediction that “rate base will not be overstated because ComEd will continue to make significant capital investments during the period in which the rates set in this proceeding will be in effect in amounts that will exceed the continued accrual of depreciation.” (Houtsma, ComEd Ex. 6.0 at 8-10:162-208). However, ComEd’s election of a historical test year requires the application of Section 287.40, which precludes future test year type forecasts and makes comparisons to such estimates inapposite.

ComEd’s misguided comparisons are conceptually the same as one the Commission recently considered – and found unpersuasive – in its *2009 Ameren Cases* decision. (*2009 Ameren Cases*,

Order on Rehearing, Nov 4, 2010 at 27). ComEd's comparisons, like that in Ameren's recent rate cases, are affected by the inclusion of investment amounts that do not meet, *inter alia*, the "known and measurable" criteria of Section 287.40. Such comparisons do not assist the Commission in evaluating the reasonableness of any proposed adjustment.

IIEC witness Gorman confirmed the flaws in Ms. Houtsma's logic by examining her comparisons exhibit, ComEd Ex. 6.3. (Gorman, IIEC Ex. 4.0 at 16:339-364). He found that the exhibit actually supports conclusions contrary to Ms. Houtsma's arguments and positions.

- ComEd Exhibit 6.3 shows that using the historical test year, ComEd's rate base would be \$7.7 billion, which is higher than the \$7.5 billion rate base that Ms. Ebrey shows for a future test year using calendar year 2011. ComEd's one-sided adjustment will result in an overstatement of the ComEd rate base used to set rates, even in comparison to a future test year.
- Even assuming similar revenue requirements, as ComEd alleges, customer rates based on a historical test year to recover this revenue requirement may not be the same as the future test year customer rates to recover the relevant revenue requirement. Various factors that affect rates directly (*e.g.*, consumption or number of customers) and the distinctive impact of economic trends on the levels and patterns of usage for various customer types can change from a historical to a future test year. (*See*, Houtsma, Jan. 20 Tr. 2346-2348). ComEd's dismissal of the distinctions between historical and future test year data obscures likely significant rate differences.
- Overstating its historical test year rate base and revenue requirement as ComEd is doing in this case, would result in an unjust increase in the rates charged to its retail customers – even if historical and future test year revenue requirements were "similar."

The Commission's test year rules provide the means for utilities anticipating significant new investment to achieve a rate base representative of a future period – a future test year filing. (83 Ill. Adm. Code 287.20, 287.30) ComEd's choice of a historical test year defined the extent to which

the Commission is able to recognize future (post-test year) rate base investment. The Commission cannot lawfully ignore its rules to please ComEd by shielding it from the effects of its test year choice.

c. Accumulated Deferred Income Taxes (ADIT)

The logic and legal requirements that compel consideration of both increases and decreases to Test Year plant investment also impel such balanced post-Test Year adjustments for other components of ComEd's rate base. Just as Gross Plant and Accumulated Depreciation are the two largest components of Net Plant, ComEd's Net Plant and Accumulated Deferred Income Taxes (ADIT) are the two largest quantities in the Commission's calculation of rate base. (*See 2009 Ameren Cases*, Order, Apr 29, 2010, Appendix B, page 5 of 13). Any post-Test Year rate base adjustments the Commission approves should take account of ADIT, as well as Accumulated Depreciation.

IIEC witness Gorman recommends a \$632.4 million correction to ComEd's proposed adjustment for additions to rate base over a period of 18 months. This correction combines IIEC's recommended correction for post-test year changes in accumulated depreciation with its proposed correction to recognize post-test year changes in ADIT. The combined correction reduces ComEd's revenue requirement by \$70.9 million. (Gorman, IIEC Ex. 1.0 at 71-73:1550-1610).

In *2009 Ameren Cases*, the Commission examined the question "whether such *pro forma* adjustments for plant additions . . . should be accompanied by an adjustment reflecting ADIT and the accumulated depreciation balance through [the end of the adjustments period] for plant existing at the end of the test year." (*2009 Ameren Cases*, Order on Rehearing, Nov 4, 2010 at 26). The

Commission concluded that an adjustment for post-test year changes in ADIT, as well as accumulated depreciation, is both appropriate and required when post-test year plant additions are added to the test year rate base.

[A]n adjustment to the ADIT balance is essentially a companion or derivative adjustment to the accumulated depreciation. Because the Commission has adopted post-test year changes in accumulated depreciation for existing plant, the Commission concludes that the companion adjustment for post-test year changes in ADIT associated with existing plant should also be made. (*Id.* at 49).

The Commission should approve IIEC's proposal for a corrective adjustment to recognize post-test year changes to this element of rate base.

VI. RATE OF RETURN

E. Cost of Common Equity

1. The Parties' Analyses

IIEC finds ComEd's proposed 11.5% return on equity (ROE) excessive. IIEC recommends an ROE of 9.6% as reasonable and appropriate under current financial market conditions and adequate to maintain ComEd's investment grade credit ratings. (Gorman, IIEC Ex. 1.0 at 2:23-38; 43:972-976). IIEC's recommendation is supported by the testimony of Michael Gorman. Mr. Gorman used three variations of the Discounted Cash Flow (DCF) analysis and a Capital Asset Pricing Model (CAPM) study to estimate the required market return for ComEd. In addition, Mr. Gorman presented a risk premium study, but did not use its result in quantifying his estimate, because of previous Commission decisions rejecting the use of that approach. Mr. Gorman identified significant errors in ComEd's ROE-related analyses and showed that they result in an

overstatement of the utility's market required return. (*See generally* Gorman, IIEC Ex. 1.0).

ComEd supports its recommended ROE with the testimony of several witnesses, a greater number of estimation approaches, and financial commentary from many of its other witnesses. (*See, e.g.,* Seligson, ComEd Ex. 12.0 Rev.(comparable earnings and risk premium estimates); Hadaway, ComEd Ex. 11.0 (DCF [three versions] and risk premium estimates); Fetter, ComEd Ex. 5.0 (credit ratings commentary,); Trpik, ComEd Ex. 4.0 Rev.(access to capital); Tierney, ComEd Ex. 13.0 (ROE adder)). ComEd also proposes a 40 basis point adder to increase whatever market required return is determined by the Commission; ComEd included the effect of the adder in its recommended 11.5% ROE. (Tierney, ComEd Ex. 13.0 at 3:46).

Staff and AG/CUB experts presented their own estimates of ComEd's required return on equity. Like Mr. Gorman, these experts used variations of DCF and CAPM analyses. Staff's expert Michael McNally presented two versions of the DCF model: constant growth and multi-stage growth studies. AG/CUB expert Christopher Thomas presented constant growth and multi-stage growth DCF models that used historical and projected internal growth rates.

The following table summarizes the parties' presentations.

| WITNESS | OVERALL | DCF | CAPM | RP | COMP. EARNINGS | SOURCE |
|-------------------------|-----------------------------------|---------------|---------------|----------|----------------|---|
| Seligson (ComEd) | 12.0% | ---- | ---- | 12.6% | 11.4% | ComEd. Ex. 12.0 at 10:221-225 |
| Hadaway (ComEd) | 10.7% - 11.3% (incl. 40 BP adder) | 10.3% - 10.9% | ---- | [10.24%] | ---- | ComEd Ex. 37.0 at 31-32:586-601 |
| McNally (Staff) | 10.0% | 9.69% | 10.32% | ---- | ---- | ICC Staff Ex. 5.0 at 21:422-426, 32:627-629, and 33:633-634 |
| Gorman (IIEC) | 9.6% | 9.8% | 9.4% | [9.72%] | ---- | IIEC Ex. 1.0 at 32:734-735 and 38:859-873 |
| Thomas (AG-CUB) | 8.94% | 8.94% | 6.69% - 9.05% | ---- | ---- | AG/CUB Ex. 4.0 at 29:592-595, 33:672-676, and 34:690-691 |

*[Bracketed estimates were not used directly in determining recommendations]

DCF and CAPM Analyses. With the notable exception of ComEd witness Carl Seligson, the ROE experts in this case who estimated ComEd's market required return relied principally on Discounted Cash Flow (DCF) or Capital Asset Pricing Model (CAPM) analyses, the approaches this Commission has approved in its recent decisions. (See, e.g., *2009 Ameren Cases*, Final Order, Apr 29, 2010 at 216; *Re: Commonwealth Edison Company*, Dkt. 07-0566, Order Sept. 10, 2008 at 98).

With respect to the Commission's preferred DCF and CAPM approaches, the major sources of the differences in parties' recommended equity returns are (a) the growth rate input to parties' DCF analyses and (b) the estimate of market risk premium component of parties' CAPM analyses. In IIEC's view, ComEd's choices for these inputs have improperly inflated its requested return on equity. For the reasons discussed in greater detail in the separate sections below, those inputs -- and the resulting ComEd recommendation -- should be rejected. Moreover, with an appropriate determination of the market required return, the further increase of ComEd's proposed 40-basis

point adder is unnecessary and excessive. ComEd's proposed adder also should be rejected.

Comparable Earnings Estimate. ComEd witnesses presented (and used) the results of two additional approaches that the Commission has traditionally not considered -- Comparable Earnings and Risk Premium methodologies. (*See generally* Seligson, ComEd Ex. 12.0 Rev.).

Mr. Seligson alone provided a comparable earnings analysis. Consistent with the Commission's historical rejection of that approach, even ComEd did not use his comparable earnings ROE estimate in quantifying the utility's requested return. And the record provides no reason for the Commission to reverse course to consider the excessive result in this case. (Gorman, IIEC Ex. 1.0 at 59:1277). In any case, as Mr. Gorman observed, the "comparable" firms Mr. Seligson uses have not been shown to have similar investment risks, types of operations, or accounting practices. (Gorman, IIEC Ex. 1.0 at 58-59:1252-1278). Moreover, the earned returns (an accounting metric) are not a measure of the required return for ComEd (a dynamic market measure). (*Id.*).

Mr. Seligson has not provided any evidence that his belief that utilities have risk comparable to the overall market is shared by any market participant or has any validity. Rather, Mr. Seligson's arguments seem to be based purely on his own subjective determination that a return on equity for ComEd should be above 12%. He has not provided any credible support for this recommendation.

(Gorman, IIEC Ex. 4.0 at 14:293-298).

Mr. Seligson's only support for his suggestion that this Commission should deviate from its consistent policy is a survey of commissions conducted more than a decade ago, wherein only one-quarter of the one-half of commissions that responded used a comparable earnings approach,

in some unspecified manner in their estimate of the cost of equity. (Seligson, ComEd Ex. 38.0 at 3:62). Mr. Seligson's recommended comparable earnings ROE should be discarded.

Risk Premium Analyses. ComEd witnesses Seligson and Hadaway each presented a Risk Premium (RP) analysis, although only Mr. Seligson used his RP result directly in determining his recommendation. In prior cases, RP estimates have been rejected by the Commission in determining an appropriate ROE. (*2009 Ameren Cases*, Final Order Apr. 29, 2010 at 216 (“... the Commission notes it has traditionally rejected risk premium analyses. The Commission finds no reason to deviate from past practice wherein it has relied on the DCF and CAPM models to estimate cost of common equity.”)). IIEC witness Gorman detailed defects in those analyses that provide additional reasons those results should not be used. In particular, Mr. Hadaway's use of problematic forecasts of Treasury and utility bond yields to determine his equity risk premium and his additional upward adjustment (to effect an assumed relationship between equity risk premiums and interest rates), inflate his RP estimate to an unreasonable level.

Mr. Gorman tested Mr. Hadaway's risk premium estimate with a comparison of yield forecasts, current yields, and actual yields for the forecasted period. His analysis showed that forecasted yields almost always overstated the yield that ultimately occurred. (Gorman, IIEC Ex. 1.0 at 50:1072-1090; IIEC Ex. 1.19). As Mr. Gorman showed in IIEC Ex. 1.19, “over the last several years, economists have been consistently projecting increases to interest rates.” (Gorman, IIEC Ex. 1.0 at 50:1086). That “review of projected changes to interest rates made over the last several years, in comparison to how accurate these projections turned out to be” shows that “observable interest rates today are as accurate as are economists' consensus projections of future

interest rates.” (*Id.* at 50:1072-1075). These projections, which Dr. Hadaway used, are highly problematic. (*Id.* at 51:1091-1092).

Dr. Hadaway also assumes a simplistic inverse relationship between equity risk premiums and interest rates, and he adjusts his estimate of a fair equity risk premium in the current marketplace to reflect that assumption. However, the actual relationship between those variables is more complicated, changes over time, and is influenced by factors other than nominal interest rates. The foundational assumption of Dr. Hadaway’s adjustment is not supported by relevant academic research. (Gorman, IIEC Ex. 1.0 at 51-52:1104-1125).

Substituting current actual yields for inaccurate adjusted forecasted yields in Dr. Hadaway’s estimation equation significantly reduces his ROE estimate -- to a level near that of Mr. Gorman’s recommendation. (Gorman, IIEC Ex. 1.0 at 52-53:1134-1141).

ComEd’s other RP analysis, Mr. Seligson’s quantification of ComEd’s estimated ROE, is at least as flawed as Dr. Hadaway’s analysis. Mr. Seligson:

- used a market risk premium more appropriate for the market as a whole, not for a below-market risk distribution utility;
- selected the highest market premium in Morningstar’s range of published estimates (5.2% - 6.7%), without explanation or justification; and
- used one of the highest available estimates of Treasury bond yields, selecting 2011 estimates, when a consensus estimate for even the next two years (4.7%)¹² was considerably lower than his 5.9% yield.

¹² Even the consensus estimate is likely overstated. “[W]hile analysts consistently project Treasury bond yields to increase, those projected increased interest rate projections have consistently turned out to be wrong and have overstated the actual Treasury yields that eventually prevailed.” (Gorman, IIEC Ex. 1.0 at 49:1064).

(Gorman, IIEC Ex. 1.0 at 59-60:1281-1314).

To provide the Commission with market information from a risk premium analytical perspective, Mr. Gorman also presented RP analyses. (Gorman, IIEC Ex. 1.0 at 2:27-29, 27:635-744, 32:737-744). Although Mr. Gorman's analyses avoid the errors he identified in ComEd's RP analyses, Mr. Gorman did not use his RP results directly in his estimation of ComEd's ROE. Mr. Gorman's analysis does, however, demonstrate the unreasonableness of the RP analyses presented by ComEd's witnesses.

2. *ComEd's Commentary Testimony*

The commentary on financial and regulatory environments from ComEd witnesses Seligson and Steven Fetter¹³ (among others) appropriately played no direct role in ComEd's quantification of its market required return. Their opinions on the current states of the financial markets and Illinois regulation do not warrant any modification of ROE estimates determined through the analysis of actual market data.

Mr. Gorman's testimony explains that Mr. Seligson's conclusion respecting the need for supportive regulation in Illinois (a) is based on risks not faced by ComEd's distribution operations and (b) attempts to compensate ComEd for risks that the utility can manage or eliminate using available regulatory mechanisms. (Gorman, IIEC Ex. 1.0 at 56:1207-1225). Mr. Fetter's testimony presents similarly flawed analyses. His assessment of Illinois dwells on past legislative issues that are now irrelevant. His more focused look at Illinois' regulatory environment dismisses the market's

¹³ References to the testimony of Mr. Fetter includes the testimony of Susan Abbott adopted by Mr. Fetter.

improved view of Illinois regulation (*Id.* at 61-62:1325-1348), and he ignores regulatory options (*e.g.*, future test year rate cases) available to ComEd to manage recovery of its costs of service. (*Id.* at 62:1352-1361). Ultimately, Mr. Fetter’s highest objective appears to be replicating other Commission awards -- “matching past returns or pleasing analysts” (Gorman, IIEC Ex. 4.0 at 10:210) -- rather than determining what the market requires for ComEd. (*See* Fetter, ComEd Ex. 45.0 at 16:314, ComEd Ex. 63.0 at 2-4:30-71).

Mr. Gorman testified, on the basis of his own assessment of current conditions, that Illinois regulation provides adequate support to ComEd’s access to capital. He supported his assessment by noting, *inter alia*, ComEd’s “Excellent” S&P credit rating business profile score and its favorable senior secured bonds ratings from S&P and Moody’s. (Gorman, IIEC Ex. 1.0 at 57:1230-1241).

3. *DCF Model Issues – Growth Rates*

The most significant differences among the DCF analyses and recommended returns in this record can be explained by the various expected growth rates used as DCF model inputs. Two questions respecting those inputs are most important. The first question is whether short-term growth rate estimates can produce a reasonable constant growth DCF study. To obtain reasonable results from such growth inputs, the three-to five-year earnings growth rate outlooks published by analysts must be reasonable estimates of long-term sustainable growth. Both Mr. Gorman and Mr. McNally reason that, to be suitable DCF constant growth inputs, the three-to five-year growth rates cannot exceed the growth rate outlook for the economy in which ComEd must operate over the infinite period used in the DCF model. The Commission has approved the same reasoning in other cases.

In ComEd's last rate case, the Commission stated:

We agree with Staff and Intervenors that Hardaway's (*sic*) conclusions, based on the assumption that utility investors expect a sustainable utility growth rate about 20% (6.05/5) greater than the economy as a whole, is unlikely." (*Commonwealth Edison Company*, Dkt. 07-0566, Final Order, Sept. 10, 2008 at 97).

The Final Order in *2009 Ameren Cases*, stated:

The Commission finds value in both Staff's and IIEC's non-constant DCF analyses, along with Staff's CAPM analysis. Each has suggested the use of a multi-stage DCF model in this instance to mitigate the impact of unsustainable analyst estimates of growth, using instead estimated proxies of U.S. GDP growth as the long-term growth rate. (*2009 Ameren Cases*, Final Order, Apr 29, 2010 at 219.

Mr. Gorman and Mr. McNally agree that current three-to five-year growth rates do exceed the expected growth rate of the economy and, therefore, are not reasonable estimates of long-term sustainable growth. (Gorman, IIEC Ex. 1.0 at 20-22:483-534; McNally, Staff Ex. 5.0 at 15:287-299). Consequently, the constant growth DCF models in this case that use current analysts' projections produce return estimates that are too high. Mr. Gorman acknowledges that flaw in his constant analysts' growth rate DCF model. Staff witness McNally reaches the same conclusion with respect to his results from using three- to five-year growth rate projections made by analysts for his sample group. (McNally, Staff Ex. 5.0 at 15:297-302). ComEd witness Hadaway did not discount his constant growth DCF estimate. He embraced that result, even though he used analysts' current, inflated three-to five-year growth rates. Dr. Hadaway used analysts' growth rate estimates and fully considered that result in his estimate, even though he acknowledges that empirical data "support the notion that long-term growth expectations are more closely predicted by broader measures of

economic growth than by near-term analysts' estimates." (Hadaway, ComEd Ex. 11.0 at 33:702-704).

Since there is no reasonable dispute that analysts' short term growth projections are not expected to persist indefinitely, each testifying expert relied to some extent on the rate of growth in the national Gross Domestic Product (GDP) as a surrogate for long term earnings growth.¹⁴ The GDP growth rate used in a constant growth DCF model or as a surrogate for long term growth in a multi-stage DCF model is particularly important. An infinite period of overstated growth has an obvious effect on the resulting estimate. The multi-stage version of the DCF formula recognizes that near term growth rates and transitional growth rates will prevail only for finite, brief periods. However, over the final, infinite period of sustainable growth the DCF model contemplates, the long term growth rate input has the greatest impact on the resulting DCF estimate. Even small differences in growth rate, applied over an infinite period as required by the DCF formula, can significantly affect ROE estimates.

Such differences appear in the analyses of the experts in this case. As shown in the table below, the relative magnitude of the ROE recommendations of record closely tracks the relative magnitude of the long term growth rate inputs used in the related constant growth and multi-stage, non-constant growth DCF models.

¹⁴ Because no firm can grow indefinitely at a pace that exceeds growth of the economy in which it operates, GDP growth represents the ceiling of reasonable long term DCF growth rate inputs.

| WITNESS | DCF GROWTH RATE INPUT | DCF RESULT | SOURCE |
|----------------------------------|---|---------------|----------------------------------|
| Hadaway (ComEd) | Constant g DCF: 5.53% - 5.59% (analysts) | 10.3% - 10.7% | IIEC Ex. 1.0 at 46:1000 |
| | Sustainable g DCF: 6.0% (GDP - derived from historical growth) | 11.0% - 11.1% | IIEC Ex. 1.0 at 46:1016 |
| | Multi-Stage g DCF: (analysts/avg/GDP) | 11.0% - 11.1% | ComEd Ex. 37.0 at 25:479 |
| | GDP = 6.0% | | |
| McNally (Staff) | Constant g DCF: 5.53% (analysts) | 9.91% | Staff Ex. 5.0 at 15:291 |
| | Multi-Stage g DCF: (analysts/avg/GDP) | 9.47% | Staff Ex. 5.0 at 21:419-422 |
| | GDP = 5.0% | | Staff Ex. 5.6 |
| Gorman (IIEC) | Constant g DCF: 5.56% (analysts) | 10.33% | IIEC Ex. 1.0 at 26, Table 2, Ex. |
| | Sustainable g DCF: 5.05% (GDP- analysts) | 9.19% | 1.4 |
| | Multi-Stage g DCF: (analy./eq. incr./GDP) | 9.89% | IIEC Ex. 1.7 |
| | GDP = 4.7% | | IIEC Ex. 1.8 |
| Thomas (AG-CUB) | Constant g DCF: 8.22% (hist. intern. growth) | 8.98% | AG/CUB Ex. 4.4 and 4.5 |
| | Constant g DCF: 8.92% (proj. intern. growth) | 9.65% | |
| | Multi-Stage g DCF: (hist. intern/avg/GDP) | 8.22% | |
| | GDP = 4.86% | 8.92% | |
| | Multi-Stage g DCF: (proj. intern/avg/GDP) | | |
| GDP = 4.86% | | | |

Multi-stage growth DCF analyses were performed by experts for IIEC, Staff, and ComEd. AG/CUB Christopher Thomas used a GDP growth rate of 4.86%. IIEC's Mr Gorman used a long-term growth rate of the economy of 4.7%. Staff used a long-term growth rate for the economy of 5%. Both IIEC's and Staff's GDP growth outlooks were based on published growth rates available to investors. In contrast, ComEd's Dr. Hadaway relied on a GDP growth rate of 6.0%.

That growth projection was based on his assessment of historical achieved GDP growth and is unlikely to have affected investors' expectations. (Hadaway, ComEd Ex. 11.3).

For the more appropriate sustainable growth rate model, Dr. Hadaway set aside analysts' growth rates only to select an excessive GDP growth rate estimate based on his massaging of historical data that is even higher. Dr. Hadaway's assessment does not appear to account for the heavy influence of inflation during the historical period he chose, and he subjectively weights certain years within the historical period differently. (Gorman, IIEC Ex. 1.0 at 46-47:1012-1024; Hadaway, ComEd Ex. 37.0 at 25:470-479). Moreover, Dr. Hadaway's opinion that GDP growth will return to past levels ignores fundamental changes in national and world economic trends. Yet, as between analysts' estimates of future GDP growth and an average of historical GDP growth rates, Hadaway chose the higher historical input.

Dr. Hadaway's historical GDP estimate was derived specifically for this litigation, is not generally available to investors, and uses a methodology not reviewed by the financial community. (Gorman, IIEC Ex. 4.0 at 5-6:109-122). The Commission should not rest its determination of just and reasonable rates on such parochial inputs.

As Mr. Gorman showed in his rebuttal testimony, had Dr. Hadaway used growth rates reflecting published analysts' growth rate outlooks in his multi-stage growth DCF model, those growth rates and the resulting DCF return estimates would have been substantially lower. (*See* Gorman, IIEC Ex. 1.0 at 48, Table 6 (showing a revision of Dr. Hadaway's DCF estimates using reasonable GDP growth forecasts)). Dr. Hadaway's selection of excessive short term growth projections as long term growth inputs to his models accounts for the excessive estimates from his

DCF analyses. Further, when using GDP growth as a surrogate for sustainable long term growth, Dr. Hadaway's selection of a GDP growth rate even higher than the short term analysts' growth projections that other experts rejected predictably yields an excessive result.

4. CAPM Analysis Issues -- Market Risk Premium

One aspect of Staff's CAPM ROE estimate is troubling. Staff estimated a DCF return on the S&P 500 stocks of 12.74%. Staff did not show the computation of the risk premium estimate used in ICC Staff Exhibit 5.10, but because it was based on a market return of 12.74%, it is at very best problematic. (McNally, Staff Ex. 5.0 at 28:549-551; Staff Ex. 5.10). Staff's DCF return on the market implies a growth rate of over 10% -- nearly twice the level of growth Staff estimated with its GDP growth rate of 5%. (McNally, Staff Ex. 5.0 at 19:365-381). Staff simply has not provided any support for the reasonableness of its S&P 500 growth rate estimate of 12.74%.

IIEC's Mr. Gorman presented an alternative approach that does not share this deficiency of Staff's risk premium derivation. It also has the reliability of an estimate based on actual market results. However, since there is some inaccuracy in any estimate of the equity market risk premium, Mr. Gorman's analysis recognizes that an estimated range of the market risk premium, used in conjunction with other more specific estimates, is a superior approach.

F. Adjustments to Rate of Return

ComEd has proposed to augment its already over-stated ROE recommendation with a 40 basis point (BP) adder. The adder would apply to whatever ROE the Commission approves. (Tierney, ComEd Ex. 13.0 at 3:46-49). According to ComEd witness Susan Tierney, the adder is necessary "to mitigate the adverse effects on ComEd's revenues that would occur as a result of the

combined effects of ‘business as usual’ ratemaking practices, full compliance with the State’s energy efficiency program goals, and the impacts of other demand-side measures on customer loads.” (*Id.* at 3:49-52). IIEC witness Gorman recommends that the Commission reject ComEd’s proposed 40 BP adder to the approved ROE.

Mr. Gorman explains that the adder is unnecessary, penalizes customers, and reduces the regulatory efficiency. The adder is not needed for ComEd to manage the risks the utility identifies as justification. The principal risk identified by Dr. Tierney is that energy efficiency and demand response (EE/DR) programs will reduce sales. However, ComEd has adequate means to respond to that risk. Ms. Tierney acknowledges that ComEd can use a future test year to set rates. (Tierney, ComEd Ex. 39.0 at 5:91).¹⁵ That approach would allow ComEd to incorporate forecasted sales levels and costs of service that take account of its anticipated EE/DR activities. A future test year would better align its cost of service with future forecasted billing units. (Gorman, IIEC Ex. 1.0 at 54:1165-1173). Thus, ComEd’s opportunity to earn its cost of capital is not subject to an unavoidable risk for which it should be compensated. However, rather than address such risk management, ComEd’s apparent position is that ComEd’s choice not to use a future test year in this case ends the discussion, and that ComEd may not be criticized for declining to manage its risks. (*See*, Tierney, ComEd Ex. 39.0 at 5:106-111).

¹⁵ While Ms. Tierney suggests that there are risks that a future test year will not eliminate, the risks she identifies are elements of rate setting that have been addressed in the past without ROE adders. Simply observing that the Commission’s rate setting process has not eliminated every risk of ComEd’s operations is not a valid complaint, nor does it satisfy ComEd’s burden of proving that a 40 BP adjustment is just and reasonable.

A future test year is not the only regulatory mechanism available to manage that risk. ComEd can mitigate sales loss risk by implementing pricing structures that do not expose ComEd to the same loss of revenue caused by reduced kWh sales. (Gorman, IIEC Ex. 4.0 at 23-24:494-518). In fact, ComEd has demonstrated both the range of available mechanisms and its ability to manage sales loss risk by simultaneously proposing a duplicative regulatory measure – increased monthly charges – that would address the very risks ComEd uses to justify increased charges to ratepayers.

With ComEd’s proposed rider in place, customer savings from EE/DR would be diminished by the higher rates the adder will produce. Moreover, the adder is wholly disconnected from the risk used to justify it. Even if no reduced usage savings were ever actually enjoyed by customers, the proposed adder would still yield higher rates and a higher authorized return for ComEd.

Substituting Commission action in the form of an adder to ComEd’s ROE in place of risk management by the utility reduces regulatory efficiency, and it excuses the utility from its responsibility to manage risks. (Gorman, IIEC Ex. 1.0 at 53-54:1159-1173; IIEC Ex. 4.0 at 23-24:499-537). ComEd’s proposed adder would substitute an inflation of its allowed ROE for more customary and more equitable responses to risk that the utility simply has declined to implement -- *viz.*, using a future test year or more refined forecasts of load changes to set rates.

In any case, the basis for a 40 basis point adder remains unexplained in this record. Though Ms. Tierney purports to “to testify on important principles of utility ratemaking that intersect with the revenue implications of implementation of energy efficiency programs,” she does not explain why that number is the correct figure or even a just and reasonable figure. In fact, the 40 basis point

figure was not even developed by Ms. Tierney. (Tierney, Jan 18 Tr. at 1822). The number was chosen by ComEd's Chief Financial Officer Joseph Trpik, who did not provide supporting testimony for the adder. Nor did he explain its derivation or objective. (Trpik, Jan 10 Tr. at 249). Ms. Tierney's task was a very narrow one: "The question that was posed to me was whether I thought a 40-basis-point adder was appropriate in the context of a filing that would include a strict -- a straight fixed/variable rate design." (Tierney, Jan 18 Tr. at 1821). Even if some basis for imposing an adder existed, there is no record basis for this particular adder.

Fundamentally, ComEd is asking ratepayers to compensate the utility for risks that it can eliminate or mitigate through its own management actions. ComEd has not explained its decision simply to forego available opportunities to account for the foreseeable changes it offers as justification for the adder. (Tierney, ComEd Ex. 39.0 at 5:106). It is neither economically efficient nor fair to ratepayers to compensate ComEd for foreseeable, manageable risks. The proposed adder should be rejected.

VII. COST OF SERVICE AND ALLOCATION ISSUES

A. Overview

IIEC participated in ComEd's last rate case, Docket 07-0566, and the most recent ComEd rate design investigation case, Docket 08-0532. In Docket 07-0566, IIEC and other parties identified several flaws in the ECOS Study presented by ComEd. (*See, Re: Commonwealth Edison Company*, Dkt. 07-0566, Order, Sept. 10, 2008 at 159-213). Specifically, IIEC pointed out that a properly performed ECOS Study recognizes that primary voltage customers benefit from the transmission, subtransmission and primary distribution systems, and that they do not use or benefit

from the secondary distribution system. (*Id.* at 173). IIEC also pointed out that a proper ECOS Study minimizes the chance that primary voltage customers would be allocated secondary distribution system costs. (*Id.*). IIEC went on to show that ComEd's ECOS Study in Docket 07-0566 allocated secondary distribution system costs to customers taking service directly from ComEd's primary system and, therefore, was not a properly performed study. (*Id.* at 175-176).

The effects of the deficiencies in ComEd Docket 07-0566 ECOS Study were clear to the Commission. The Commission determined:

... the proper assignment of primary and secondary distribution costs would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage and Railroad classes. (*Id.* at 213).

The Commission specifically found that the ECOS Study presented by ComEd in Docket 07-0566 was "... deficient in not separating and properly allocating primary and secondary service costs." (*Id.* at 207). The Commission went on to conclude "... as we have noted, the substantial deficiencies in specific elements of the ECOS Study render it problematic for purposes of setting rates in this docket." (*Id.* at 213). As a result, the Commission refused to move rates for the ELL, HV and Railroad delivery service classes ComEd's recommended fifty percent (50%) of the way to cost of service, as measured by its flawed ECOS Study. Instead, the Commission determined that rates should be moved only twenty-five percent (25%) of the way to cost as measured by that study. (*Id.* at 213, 236-237).

Also, on the same day the Commission entered its Final Order in Docket 07-0566, it initiated an investigation of ComEd's rate design pursuant to Section 9-250 of the PUA. (220 ILCS 5/9-250). (*Illinois Com. Comm'n v. Commonwealth Edison Company*, Dkt. 08-0532, Initiating Order,

September 10, 2008). In its Initiating Order, the Commission again identified the deficiencies it had found in ComEd's Docket 07-0566 ECOS Study, including its finding that the study failed to separate and properly allocate primary and secondary service costs. (*Id.* at 2). To facilitate the rate investigation, the Commission directed ComEd to provide an updated ECOS Study that:

- (1) differentiated between primary and secondary voltage levels;
- (2) analyzed the cost of providing Customer Care to a customer taking supply from an alternative supplier vs. the cost of providing Customer Care to a customer taking supply from ComEd;
- (3) analyzed the extent to which usage contributed to certain kinds of customer costs and whether factors other than the number of customers in a class should be taken into account in the assignment of such cost;
- (4) allocated uncollectible expense across all residential rate classes; and
- (5) took into account ownership and maintenance responsibilities for street lighting in the City of Chicago and other municipalities and allocated costs accordingly.
(*Id.*).

The Commission determined that the requested ECOS Study and analyses were needed to determine the changes, if any, necessary to ensure that ComEd's rate structure was just and reasonable. (*Id.* at 3).

In its Final Order in Docket 08-0532 the Commission again highlighted ComEd's failure to separate and properly allocate primary and secondary service costs as a major deficiency in ComEd's ECOS Study. (*Illinois Com. Comm'n v. Commonwealth Edison Company*, Investigation of Rate Design Pursuant to Section 9-250 of the Public Utilities Act, Dkt. 08-0532, Final Order, April 21, 2010 (the "Rate Design Investigation Order" or "RDIO") at 35). The RDIO noted IIEC's

position that ComEd’s definition of its primary and secondary systems categorized certain facilities as primary, even though they were used exclusively or primarily to provide service at secondary voltages. (*Id.* at 37). The RDIO also noted IIEC’s challenges to ComEd’s classification of line transformers and single-phase primary voltage level circuits as primary system facilities. The Commission agreed that line transformers used exclusively to serve customers at secondary voltage were not properly allocated to customers taking service at primary voltage. Specifically, the Commission stated:

We find that ComEd’s current method of allocating transformer costs is not appropriate. When the existing voltage of the transformer is secondary, the transformer can only serve secondary customers and should be allocated as a secondary system cost. (*Id.* at 38).

The Commission also directed the parties to explore, in subsequent rate proceedings, whether certain techniques could be used to allocate costs to customer classes for underground circuits operating at primary voltage, but serving customers only at secondary voltage. (*Id.*). Finally, the Commission, consistent with its overall conclusions, directed ComEd: “to develop and provide in its next rate proceeding:

- (1) direct observation or sampling and estimation techniques of ComEd’s system to develop more accurate and transparent differentiation of primary and secondary costs;
- (2) other utilities’ methods of differentiating primary and secondary systems and costs;
- (3) function based definitions of service voltages for facilities other than the line transformers already addressed;
- (4) an analysis of which customer groups are served by which system service

component; and

- (5) consideration of redefining rate classes on the basis of voltage or equipment usage to better reflect the cost of service.”
(*Id.* at 40).

In spite of the Commission’s directives, ComEd presented a cost of service study in its direct testimony (ComEd Ex. 15.1) that did not comply with all of those directives. (*See, Alongi, ComEd Ex. 16.0 3rd Rev. at 1:13-19; 5:117-126; 29-31:537-576; Heintz, ComEd Ex. 15.0 Rev. at 2:24-31; Hemphill, ComEd Ex. 14.0 Rev. at 7-8:155-165; Stowe, IIEC Ex. 3.0-C at 3-5:75-105, 6-7:137-151*). ComEd was granted leave to present supplemental direct testimony in order to present an additional ECOS Study that would comply with the Commission’s directives. (Notice of ALJs’ Ruling, Sept. 17, 2010, (granting ComEd’s Motion to File Supplemental Testimony)). However, the ECOS Study filed in the supplemental testimony (Heintz, ComEd. Ex. 22.1) also failed to comply with the Commission’s directives for function based definitions for facilities. (Stowe, IIEC Ex. 3.0-C at 5:109-123; 6-7:137-151). ComEd then presented three more ECOS Studies in its rebuttal testimony, (Heintz, ComEd Exs. 51.1, 51.2 and 51.3). Each of these studies failed to fully comply with the Commission’s directives as well. (Stowe, IIEC Ex.6.0 at 6-7:105-120). Finally, ComEd presented in surrebuttal three more ECOS Studies (Heintz, ComEd. Ex. 75.1, 75.2 and 75.3), which, like their predecessors, also failed to fully comply with the Commission’s prior directives.

While ComEd’s studies make certain corrections recommended by IIEC, they still do not fully comply with the Commission RDIO directives. These studies do not use function-based definitions for single phase primary facilities and, therefore, misallocate the cost of these facilities to primary

voltage customers.¹⁶

IIEC will confine its discussion principally to the deficiencies in ComEd's last three ECOS Studies, referring to them as ComEd's "Proposed ECOS Study" (ComEd Ex. 75.1), ComEd's "Preferred Exemplar ECOS Study" (ComEd Ex. 75.2) and ComEd's "Alternative Exemplar ECOS Study" (ComEd Ex. 75.3). IIEC will discuss the deficiencies in ComEd's first five ECOS Studies only to the extent they continue to exist in the ECOS Studies presented in ComEd's surrebuttal testimony.

The table below indexes the eight ECOS Studies presented by ComEd in this case. This table is based on Table 1 of IIEC witness Stowe's rebuttal testimony. (Stowe, IIEC Ex. 6.0 at 2) updated and modified to reflect the addition of ComEd's three surrebuttal ECOS Studies.

¹⁶ IIEC identified calculation and cell reference errors in the ECOS Studies ComEd presented in its direct and supplemental direct testimonies unrelated to RDIO compliance issues. (Stowe, IIEC Ex.3 .0-C at 27-28:620-626). ComEd corrected those errors in the ECOS Studies it presented in rebuttal, but IIEC identified new mathematical errors in the ComEd rebuttal ECOS Studies. (Stowe, IIEC Ex. 6.0 at 16:356-370). In surrebuttal, ComEd again corrected the identified errors in the ECOS Studies (Heintz, ComEd Ex. 75.0 at 2:28-31). This brief will not address this series of errors in ComEd's ECOS Studies because ComEd has corrected them.

| <u>Index of ComEd ECOS Studies</u> | | |
|---|---|---|
| ComEd Exhibit | Description | Comments |
| 15.1 | Filed with ComEd’s direct testimony, uses ComEd’s current rate class structure. | Same P/S analysis as presented in 08-0532 - (ComEd Ex. 16.5) supported by ComEd despite rejection by Commission in 08-0532. |
| 22.1 | Filed with ComEd’s supplemental direct testimony, uses “exemplar” Primary Voltage Delivery (“PVD”) class structure. | Uses modified P/S analysis (ComEd Ex. 21.5). Presented as compliant with RDIO - not supported by ComEd. |
| 51.1 | ComEd’s Proposed ECOS Study in rebuttal testimony. Revises ComEd Ex. 15.1 to reflect ComEd’s rebuttal revenue request and to correct certain errors, uses ComEd’s current rate class structure. | A revised version of ComEd’s ECOS Study presented in direct testimony. |
| 51.2 | ComEd’s Preferred Exemplar ECOS Study in rebuttal testimony. Revises ComEd Ex. 22.1 to reflect ComEd’s rebuttal revenue request and to correct certain errors, uses “exemplar” PVD class structure, divided into 2 subclasses | A revised version of ComEd’s ECOS Study presented in supplemental direct testimony. |
| 51.3 | ComEd’s Alternative Exemplar ECOS Study in rebuttal testimony. Was provided in response to IIEC Data Request 7.01. | A hybrid ECOS Study using components of ComEd’s Proposed and Preferred Exemplar ECOS Studies in rebuttal testimony |
| 75.1 | ComEd’s Proposed ECOS Study in surrebuttal testimony. Revises ComEd Ex. 51.1 to correct certain errors identified in intervenor rebuttal testimony, uses ComEd’s current rate class structure. (“Proposed ECOS Study”). | This ECOS Study is the same as ComEd Ex. 51.1 except for the certain corrections described by ComEd witness Heintz. |
| 75.2 | ComEd’s Preferred Exemplar ECOS Study in surrebuttal testimony. Revises ComEd Ex. 51.2 to correct certain errors, uses “exemplar” PVD class structure, divided into 2 subclasses (“Preferred Exemplar ECOS Study”) | A revised version of ComEd’s ComEd Ex. 51.2 |
| 75.3 | ComEd’s Alternative Exemplar ECOS Study in surrebuttal testimony. Revises Ex. 51.3 (“Alternative Exemplar ECOS Study”) | A revised version of ComEd Ex. 51.3. |

IIEC, on the other hand, has presented a cost of service study that complies with the RDIO directives, but uses NCP allocators for primary lines and substations instead of the CP allocators. (See, Stowe, IIEC Ex. 6.0 at 17-22:381-459). IIEC’s ECOS Study does not incorporate IIEC’s proposed allocation of the IEDT, although IIEC explained that such an incorporation can be made

readily if the Commission approves same. (Stephens, IIEC Ex. 2.0-C at 26:600-605).

C. Potentially Contested Issues

1. Embedded Cost of Service Study Issues

a. Class Definitions

(ii) Non-Residential

Definition of delivery service classes is a prerequisite to determining class cost of service. Said differently, one must define the customer classes before one can seek to determine the level of cost caused by each class. Differing rate class definitions account for some of the variation in the ECOS Studies presented in this case.

ComEd's Proposed ECOS Study, presented in ComEd Ex. 75.1, utilizes existing delivery service class definitions. ComEd's Preferred Exemplar ECOS Study, presented in ComEd Ex. 75.2, redefines the delivery service classes by creating a new PVD class, consisting of customers removed from the SL, ML, LL, VLL and ELL delivery classes – thus redefining those classes as well. Finally, ComEd's Alternative Exemplar ECOS Study, presented in ComEd Ex. 75.3, uses existing delivery service class definitions, but differentiates primary and secondary subclasses within the existing classes. (*See*, Heintz, ComEd Ex. 51.0 at 4-5:81-97 and Heintz, ComEd Ex. 75.0 at 1:19-20).

IIEC's ECOS Study, presented by IIEC witness Stowe in IIEC Ex. 3.0-C and IIEC Ex. 6.0, utilizes existing rate class definitions, but divides the SL through ELL classes into primary and

secondary service subclasses, in order to examine the cost of serving these subclasses.¹⁷ Thus, it most closely resembles ComEd's Alternative Exemplar ECOS Study (ComEd Ex. 75.3) in this regard.

IIEC opposes ComEd's Proposed ECOS Study (ComEd Ex. 75.1) (and its predecessors) because, in addition to the flaws discussed below, it does not provide for voltage differentiated subclasses in the ML through ELL classes. (Stephens, IIEC Ex. 5.0-C at 23:522-525). IIEC opposes ComEd's Preferred Exemplar ECOS Study (ComEd Ex. 75.2) (and its predecessors) because, among other things, it utilizes a new PVD service class that aggregates customers with dissimilar costs.¹⁸ IIEC proposes that the current delivery service rate classes be retained and that the distinctive delivery service costs associated with voltage differences be reflected by creating two subclasses within the ML, LL, VLL and ELL delivery service rate classes, a primary voltage subclass and a secondary voltage subclass. (Stephens, IIEC Ex. 2.0 at 16-17:404-411). IIEC opposes ComEd's Alternative Exemplar ECOS Study (and its predecessors) as inferior to IIEC's ECOS Study. The Alternative Exemplar rate structure is similar to IIEC's recommended rate structure. However, IIEC's rate structure is preferable to ComEd's Alternative Exemplar rate structure for examining class costs in this case, because it best meets the RDIO's voltage differentiated class directive.

¹⁷ Although IIEC's ECOS Study evaluates the costs caused by both primary secondary subclasses within the Small Load delivery class, there is such a minute fraction of customers in this class that take service at primary voltage, i.e., 0.04%, IIEC's rate design does not calculate separate charges for this class. (Stephens, IIEC Ex. 2.0-C at 16, fn. 6). If the Commission finds there should be separate charges within the Small Load class as well, IIEC would not object.

¹⁸ IIEC identifies and discusses more specifically, the problems with the proposed PVD rate class in Section VIII.C.3.b. of this brief.

b. Primary/Secondary Split

(i) Appropriate Methodology/Compliance with Docket No. 08-0532

(a) Functional Identification of Costs

i. Line Transformers

ComEd has performed two P/S analyses in this case. The results of ComEd's first P/S analysis, which was presented in ComEd Ex. 16.5, were used in all iterations of ComEd's Proposed ECOS study (ComEd Ex. 15.1, ComEd Ex. 51.1 and ComEd Ex. 75.1). (Alongi, ComEd Ex. 49.0 Rev. at 22:488-490; Alongi, Jan. 19 Tr. 2083). Similarly, the results of ComEd's second P/S analysis, presented in ComEd Ex. 21.5, or a version of this Exhibit were used in all iterations of ComEd's Preferred Exemplar ECOS study (ComEd Ex. 22.1, ComEd Ex. 51.2, and ComEd Ex. 75.2) and its Alternative Exemplar ECOS study (ComEd Ex. 51.3 and ComEd Ex. 75.3).¹⁹ (See, Alongi, ComEd Ex. 21.0 2nd Rev at 19-281-308, ComEd Ex. 49.0 at 22-23:496-502; Alongi, Jan. 11 Tr. 2083). Because ComEd's ECOS studies rely on the results of its P/S analyses, errors in the P/S analyses result in errors in the associated ECOS studies and associated rate designs.

The most obvious error found in ComEd's P/S analyses is that ComEd continues to define facilities as primary or secondary based on the facilities' energized voltage levels, rather than using a functional definition as directed by the Commission. (Stowe, IIEC Ex. 3.0-C at 11:249-262). For example, in its RDIO, the Commission found: "... that the cost of line transformers used exclusively

¹⁹ ComEd modified ComEd Ex. 21.5 in rebuttal, and identified the modified version as ComEd Ex. 49.4. (Alongi, ComEd Ex. 49.0 Rev. At 22-23:496-502).

to serve customers at secondary voltages should not be allocated to customers taking service at primary voltages.” (RDIO at 38). Nevertheless, ComEd's first P/S analysis fails to identify line transformer costs on a functional basis as directed. (ComEd Ex. 16.5). In addition, this P/S analysis fails to separate (by function) the costs of single-phase primary facilities – which are used nearly exclusively to serve secondary customers – from the costs of three phase facilities used to serve both primary and secondary customers. (*Id.*). ComEd’s second P/S analysis (ComEd Ex. 21.5) *does* separate line transformer costs as directed by the Commission. However, like its first P/S analysis, ComEd’s second P/S analysis also fails to identify single-phase primary facilities appropriately. (Stowe, IIEC Ex. 6.0 at 6-7:115-120).

Given the unambiguous nature of the Commission’s RDIO directive regarding line transformers, one would reasonably expect ComEd to develop a P/S analysis, ECOS study, and rate design wherein the cost of line transformers used exclusively to serve secondary voltage customers would be allocated exclusively to secondary voltage customers. However, that is not the case. The first P/S analysis ComEd presented in this case (ComEd Ex. 16.5) does not functionally separate the cost of line transformers. Consequently, ComEd's Proposed ECOS study (ComEd Ex. 75.1), which is based the results of the analysis presented the P/S analysis in ComEd Ex. 16.5, does not functionally separate these costs, but instead allocates them to primary and secondary customers (Alongi, Jan. 19 Tr. 2114-2115).

In his direct testimony, ComEd witness Lawrence Alongi claims that ComEd “sought to comply to the greatest extent practical” with the directives of the Commission’s order in Docket No. 08-0532, “given the limited time that was available between the issuance of that order and its initial

filing of this case.” (Alongi, ComEd Ex. 16.0 3rd Rev. at 29:539-542) Mr. Alongi provided a list of the Commission’s directives with which ComEd’s initial filing allegedly complied. ComEd addressed the following directives:

- ComEd allocated the costs of substations and primary lines on the basis of coincident peak (“CP”).
- ComEd made cost allocation adjustments that reallocate costs from the Dusk to Dawn Lighting Delivery Class to other classes to reflect the method presented by Chicago in the Rate Design Investigation (“the Chicago Method”).
- ComEd separated billing and data management costs, customer installations expenses, service connection or drop costs, and customer information costs between residential and nonresidential customers
- ComEd allocated customer information costs for the residential classes based on usage (i.e., kWhs delivered).
- ComEd identified and allocated uncollectible costs associated with residential customers evenly across the residential delivery classes. (*Id.* at 29-30:541-562).

Conspicuous by its absence is the Commission’s directive regarding the allocation of line transformers. Indeed, ComEd’s initial filing incorporated ComEd’s first P/S analysis (ComEd Ex. 16.5) which, as noted, fails to separate the cost of line transformers on a functional basis. ComEd promised to file supplemental direct testimony wherein it would “seek to comply fully with” the RDIO. (Alongi, ComEd Ex.16.0 3rd Rev. at 30:564-565). ComEd clearly recognized that its first P/S analysis and the associated ECOS study and rate design did not fully comply with the Commission directives; hence, ComEd’s promise of full compliance in a later filing. Notwithstanding ComEd’s promise, ComEd’s subsequent iterations of its Proposed ECOS studies

(ComEd Ex. 50.1 and ComEd Ex. 75.1) are also based on that non-compliant P/S analysis (ComEd Ex. 16.5). (ComEd Ex. 49.0 Rev. at 22:488-490; Alongi, Jan 19 Tr. 2083). The evidence shows that in ComEd’s Proposed ECOS study and its predecessors, the costs of line transformers have been allocated to both primary and secondary voltage customers in the same manner the Commission found improper in the RDIO.

ii. Single-Phase Primary Lines.

Similar to line transformers, certain other facilities energized at primary voltages function only to serve customers at secondary voltages. The Commission recognized the importance of function in its RDIO, expanding the lesson of its line transformer finding by directing ComEd to develop and provide, in this rate proceeding, “function based definitions of service voltages for facilities other than the line transformers. . .”. (RDIO at 40, (emphasis added)).

ComEd has ignored this directive in both its P/S analyses (ComEd Ex. 16.5 and ComEd Ex. 22.5). ComEd continues to separate distribution costs into primary and secondary sub-functions on the basis of a facility’s energized voltage rather than its function. Often that function is serving customers at a lower voltage. ComEd’s failure to provide “function based definitions of service voltages of facilities” was at the heart of ComEd’s inappropriate allocation of line transformer costs. That same failure affects the utility’s categorization of the costs of other types of facilities.

In particular, ComEd’s P/S analyses continue to assign single-phase primary circuits on the basis of voltage level rather than function. (Stowe, IIEC Ex. 3.0-C at 11:249-254). In electrical distribution systems, the term “phase” simply refers to an energized conductor. Single-phase primary distribution circuits are composed of a single conductor that is energized to a primary

voltage level, and a ground or neutral conductor. Three-phase primary distribution circuits consist of three energized conductors and a ground or neutral conductor. (Stowe, IIEC Ex. 3.0-C at 11:266-271). Because serving a primary voltage customer using single-phase distribution circuits can lead to localized system load imbalances and voltage instabilities, costs of single-phase primary distribution circuits are incurred predominantly, if not exclusively, to serve secondary voltage customers. (Stowe, IIEC Ex. 3.0-C at 12:280-290). ComEd witness Alongi's testimony that only 21 (2.2%) of ComEd's 936 primary voltage customers receive their service from primary feeders that are configured as single-phase circuits confirms Mr. Stowe's analysis. (Alongi, Jan. 19 Tr. 2089-2091).

ComEd identifies the costs of single-phase primary circuits as "shared" costs (costs incurred to serve both primary and secondary customers) simply because those circuits operate at primary voltage levels and despite the fact that single-phase primary circuits are rarely, if ever, used to serve primary customers. (Stowe, IIEC Ex. 3.0-C at 12:284-290).²⁰ Costs associated with facilities used to serve secondary customers, like single-phase components, should be allocated to secondary customers.

Both of ComEd's P/S analyses, (ComEd Ex. 16.5 and ComEd Ex. 21.5) combine the costs of single-phase and multi-phase circuits and allocate them on the same basis. When the results of ComEd's flawed P/S analysis are reflected in its ECOS studies, single-phase primary circuit costs

²⁰ Although 2.2% of primary voltage customers receive single phase service, hundreds of thousands, or millions, of secondary voltage customers utilize single-phase primary facilities. The single-phase facilities used to serve these 21 customers is likely a *de minimis* fraction, *i.e.*, much less than 2.2%, of the single phase primary facilities to serve secondary customers

are misallocated and the cost of distributing electricity to primary customers is overstated. Such a result is inconsistent with the Commission's prior orders, and the evidence in this case. Therefore, the P/S analysis should be modified as suggested by IIEC.

**d. NCP vs. CP
and
e. Allocation of Primary Lines and Substations**

In Docket 08-0532, the Commission was persuaded that the allocation of costs associated with distribution substations and primary lines should be made on a CP basis because; (1) substations and primary lines were not "sized to meet the demands of any single class, but rather the collective demands of customers from multiple classes, and (2) lighting class demand does not coincide with system peak demands, and therefore plays a lesser role in shaping substation and primary line investments than class demands that are coincident with the system peak. (Stowe, IIEC Ex. 3.0-C at 21:462-474, quoting from the RDIO). In IIEC's view, such an allocation is inconsistent with actual cost causation on the ComEd system. (Stowe, IIEC Ex. 3.0-C at 20:454-458).²¹

With regard to the Commission's first stated basis for its conclusion, i.e., that substations and primary lines were not sized to meet the demands of any single class, but rather the collective demands of customers from multiple classes, IIEC witness Stowe has provided un-refuted testimony that the NCP method, like the CP method, reflects the demands of all classes. Mr. Stowe testified

²¹ IIEC recognizes that ComEd has used the CP allocation at the direction of the Commission, but is requesting that the Commission reconsider the wisdom of using this allocation for primary lines and substations.

that “[t]he difference between the two methods is that the CP method focuses on the load contribution of each class during a particular hour of the year, whereas the NCP method reflects a theoretical or “worst case” estimate of the potential load distributions.” (Stowe, IIEC Ex. 3.0-C at 23:521-524). Therefore, while the Commission is certainly correct that substations and primary lines are sized to meet the collective demands of customers from multiple classes, this fact does not disqualify the NCP method since the NCP method considers the collective demand of all classes as well.

The Commission’s second concern, i.e., that lighting class demand does not coincide with the system peak demand, and therefore, plays a lesser role in shaping the substation and primary line investments, is based on the faulty assumption that distribution facilities (as opposed to transmission or generation facilities) are designed to serve the system peak demand. Certainly if utility engineers and planners designed primary distribution circuits and substations to serve the load of the customers connected to them at the time of the system peak, the use of the CP allocation method would be reasonable and appropriate. However, such is not the case. Primary circuits and substations are designed to provide safe and reliable power under both normal *and* extraordinary conditions, and at any time of the day. (Stowe, IIEC Ex. 3.0-C at 21:481-486).

ComEd witness Michael McMahan, a professional electrical engineer, testified that in preparing to construct or enhance distribution facilities, distribution system designers look at the “aggregate” or “area” load that the particular distribution facilities (e.g., particular substations or primary circuits) must serve, not the system loads. (McMahan, Jan. 11 Tr. 501-502). This aggregate load is based on ComEd’s “1 in 10-year” planning criteria, which use the highest annual system peak

load in the previous 10 years combined with a projected load forecast for the particular distribution facilities in question. (McMahan, Jan. 11 Tr. 500-501). By using the highest single load in a 10-year period, and then increasing this load by a projected load estimate as Mr. McMahan describes, system planners develop a load estimate that will occur only in worst-case situations.

The test year CP demands that ComEd used to allocate costs in this case reflect the class loads during a single hour of a summer day in 2009. These CP demands have no meaningful relationship to the aggregate or area load estimates used by ComEd engineers to design and construct distribution facilities. NCP demands, however, reflect the maximum potential demand of the customer classes served via the distribution system, regardless of when that demand occurs. In fact, the NCP can be viewed as a measure of the potential contribution of each class to cost causation because the sum of the NCP demands for all customer classes represents the capacity of the distribution system that stands by to serve the electrical demands of all customers at any given time. (Rukosuev, Jan 13 Tr 1199-1200). The NCP demands provide a reasonable proxy for the aggregate load estimate used by system planners.

Moreover, ComEd has testified in this case, as well as in Docket 08-0532, that it designs its primary lines and substations on the basis of NCP, and not CP, demands. ComEd witness Garcia states:

ComEd designs its primary lines and substations based on the non-coincident peak that occurs on those facilities, not the system coincident peak. Likewise, the Commission agreed in its Final Order in ComEd's 2007 Rate Case that the record showed that "[d]istribution facilities must be planned and built to meet customers' maximum loads, regardless of when those may occur." Docket No. 07-0566, Final Order at 217. Consequently, it is reasonable to me that

the costs of such facilities would be allocated on the basis of NCP. (ComEd Ex. 50.0 at 5-6:118-125 quoting from Docket No. 08-0532, ComEd Ex. 10.0 at 27:570-576).

Clearly, the NCP method more accurately reflects costs caused by the collective demands of all ComEd's customer classes, because the class NCP demands are more consistent with the aggregate of load estimates that ComEd uses when it designs its primary circuits and substations.

The testimonies of ComEd witnesses McMahan and Garcia comport with the direct testimony of IIEC witness Stowe. Mr. Stowe, also a professional electrical engineer, stated "system designers cannot simply design the primary circuits and substations to distribute the amount of power that flowed through the primary distribution system during a historical system peak hour." Rather, they must rely on estimates – in particular, 'worst case' estimates – when designing the system for future use." (Stowe, IIEC Ex. 3.0-C at 21-22:487-490).

Mr. Stowe has further testified that it is the CP method - not the NCP method - that fails to reflect the combined customer class load that ComEd distribution designers relied upon when they designed the Company's primary lines and substations. (Stowe, IIEC Ex. 3.0-C at 22-23:498-513). As such, the CP method fails to allocate costs in accordance with how those costs were incurred. Mr. Stowe testified that the "NCP demands of the Fixture Included Lighting and Dawn-to-Dusk lighting classes are nearly 7,300% of, or 73 times, their respective CP demands."²² (Stowe, IIEC Ex. 3.0-C at 22:493-494). Therefore, when ComEd designs, builds, upgrades and maintains its primary lines and substations, incurring investments and expenses to serve the NCP demand of its customers, yet allocates these costs to the classes on the basis of class CP demand, it significantly

²² Even the average demand of these classes is 32 times their respective CP demand.

understates the costs incurred to serve Fixture Included Lighting and Dawn-to-Dusk lighting classes. Stated alternatively, “[w]hen ComEd designs and builds its primary circuits and lines, the NCP loads of the Fixture Included Lighting and Dawn-to-Dusk lighting classes weigh more heavily in that process than the CP demands used to allocate costs.” (Stowe, IIEC Ex. 3.0-C at 22:494-497). This is the case because the CP demands that are used to allocate costs are derived from the class contribution to the test year’s system peak demand, whereas the aggregate load estimate for primary lines and substations are based on the highest “1 in 10-year” demand plus projected demand on those facilities. (McMahan, Jan. 11 Tr. 500-501).

The use of NCP method to allocate primary distribution costs is also the industry’s preferred method for allocating distribution substation and primary lines, as indicated in the 1992 publication of the National Association of Regulatory Utility Commissioners Electric Utility Cost Allocation Manual (“NARUC Manual”):

Distribution substations are designed to meet the maximum load from the distribution feeders emanating from the substation. Similarly, when designing primary and secondary distribution feeders, the distribution engineer ensures that sufficient conductor and transformer capacity is available to meet the customer’s loads at the primary- and secondary-distribution service levels... **Consequently, customer-class non-coincident demands (NCPs)** and individual customer maximum demands are the load characteristics that are normally used to allocate the demand component of distribution facilities... **The load diversity at *distribution substations and primary feeders* is usually high. For this reason, customer-class peaks are normally used for the allocation of these facilities.** (NARUC Manual at 96 and 97). (Stowe, IIEC Ex. 3.0-C at 24:535-546) (emphasis added).

Under the circumstances, IIEC respectfully recommends the Commission direct ComEd to continue to use the NCP allocator for the allocation of primary lines and substations. Use of that allocator is consistent with industry practice, cost causation, and the evidence presented in this case.

h. Allocation of Illinois Electricity Distribution Tax

Since the elimination of the personal property tax in 1970, Illinois utilities have been subject to a tax on invested capital, pursuant to the Public Utilities Revenue Act (35 ILCS 620/1 et. seq.). Prior to 1998, for electric utilities, the tax was assessed at a rate of 0.8%. In 1997, in conjunction with the Electric Service Customer Choice and Rate Relief Law of 1997, (the “Restructuring Law” - Public Act 90-561), the Illinois legislature determined that it would change the computation of the tax to keep it competitively neutral, while maintaining essentially the same level of tax revenues (adjusted for inflation) from each of the Illinois electric utilities, individually and in the aggregate, through a series of charges designed to be applied to each utility’s delivered energy. (35 ILCS 620/1(a)). It has been argued that the tax paid by ComEd is a function of kWh delivered. (Alongi, ComEd Ex. 16.0 3rd Rev. at 18:392-393; Lazare, Staff Ex. 26.0 at 21-22:492-498). IIEC explains in testimony and below why this is not the case. On the basis of evidence showing the actual causative factors for the IEDT amounts imposed on ComEd, IIEC recommends a change in the allocation of the IEDT. Cost causation and the evidence of record require that the IEDT, which is now allocated exclusively on the basis of kWh delivered, be allocated only partly on the basis of kWh delivered and partly on the basis of plant in-service.

a. *Reasonableness of Current Allocation*

The level of the IEDT was fixed at the level of tax imposed on electric utilities, on the basis of their invested capital (plant investment), prior to 1998. (Stephens, IIEC Ex. 2.0-C at 21:492-495; Lazare, Staff Ex. 26.0 at 20:455-458). It has escalated each year by 5% or the percentage increase in the Consumer Price Index (“CPI”), whichever is less. (Stephens, IIEC Ex. 2.0-C at 21:492-495; Lazare, Staff Ex. 26.0 at 21:476-480). Thus, the total amount of tax imposed on Illinois electric utilities is capped at the level of tax on invested capital experienced by each utility in 1997, subject only to inflationary adjustments. The tax is not, and never has been, exclusively a function of kWh delivered.

While the growth in the level of the tax beyond the 1997 level is somewhat related to growth in kWh deliveries, that relationship exists only to a point. As noted above, the tax is essentially capped at the pre-1998 level of the invested capital tax adjusted for inflation. Therefore, per kWh sales/deliveries can play only a small role in the determination of the amount of tax paid by each utility.

In fact, if the cap is reached in any particular year, increases in the number of kWh delivered by a utility do not automatically translate to additional IEDT responsibility. Collected tax revenues in excess of the cap in a given year are refunded to the utilities in proportion to their tax payments. (Stephens, IIEC Ex. 2.0-C at 21:492-499). Since the cap has been exceeded in every year since the IEDT was initiated (*Id.* at 21:500-501), increases in kWh sales have not increased the utility’s real tax burden beyond the cap in any year since 1997. (*Id.* at 21:501-504). Thus, ComEd’s current tax responsibility is not strictly a function of increases or decreases in kWh sales.

There are additional reasons, grounded in unrebutted empirical evidence, why the claim that the IEDT is a direct function of kWh deliveries is incorrect. As IIEC witness Stephens demonstrated, when the IEDT cap is exceeded (as it regularly is) a utility's tax burden is dependent more on its proportional share of tax payments, in relation to other utilities, than it is on the change in its own kWh deliveries. (Stephens, IIEC Ex. 2.2). If the utility maintains the same proportional share of deliveries over time, it makes no difference whether it delivers more or fewer kWh in a year; its tax burden remains the same, adjusted only for the lesser of a non-energy related 5% or the percentage change in the CPI. (Stephens, IIEC Ex. 2.0-C at 22-23:515-539). In fact, it is possible for the utility's tax burden to go down when its deliveries of kWh go up, and *vice versa*. (*Id.* at 22:509-513).

Furthermore, there is not even a high statistical correlation between ComEd's tax burden and its kWh deliveries. IIEC witness Stephens presented a linear regression analysis of the relationship between IEDT paid by ComEd and total billed energy by ComEd for the years 2001 through and including 2009. (Stephens, IIEC Ex. 2.3). This unrebutted analysis demonstrated that kWh deliveries had only a weak explanative value for changes in the IEDT, which has a base amount that is exclusively a function of ComEd's pre-1998 invested capital. (Stephens, IIEC Ex. 2.0-C at 23-24:540-557). Thus, contrary to the position of Staff and ComEd, ComEd's kWh sales do not cause (or even adequately explain) the levels of ComEd's IEDT burden.

In sum, ComEd's 1997 IEDT payments represent 91.5% of ComEd's 2009 test year IEDT, and that payment was exclusively a function of the 1997 invested capital tax paid by ComEd. ComEd's 2009 IEDT of \$108.8 million is only about 8.5% above the 1997 invested capital tax that

was determined exclusively by the tax on ComEd's invested capital – wholly apart from its kWh deliveries. (*Id.* at 24:568-672). Under the circumstances, it is unreasonable to continue to allocate IEDT on the empirically rebutted presumption that it is exclusively a function of kWh delivered.

b. IIEC Recommended Allocation

There is no credible basis for claiming that 100% of ComEd's IEDT responsibility is related to kWh sales, when over 90% of the tax responsibility is fixed at the level of ComEd's 1997 invested capital tax, with only the remaining 8.5% affected to some small degree by kWh sales. Accordingly, IIEC recommends an allocation approach that gives recognition to these facts and to the Commission's policy of allocations on the basis of cost causation. IIEC proposes to recognize the empirical causes of IEDT through distinct causal categories and different allocation factors in ComEd's cost of service study.

The first category would be the portion of IEDT attributable to ComEd's 1997 levels of IEDT (\$99.5 million). This cost category would be allocated on the basis of plant in service, recognizing that this portion of the IEDT approximates ComEd's 1997 investment-based IEDT. This portion of the tax would be recovered in distribution delivery charges as is currently the case. (Stephens, IIEC Ex. 2.0-C at 25:584-590).

The second category would consist of the remaining portion of IEDT (\$9 million), which is partly a function of ComEd's kWh delivered, at least in some years. That portion of IEDT would be allocated based on kWh sales, using the allocation factors developed by ComEd in its cost of service study. In addition, if the Commission determines that the portion of the tax that bears some

relationship to kWh delivered should be collected from customers through a separate charge on a per kWh basis, this portion of the tax could be collected in that manner. (*Id.* at 25-26:591-599).

Although changes in plant levels do not affect the IEDT on a going-forward basis, over 90% of ComEd's current tax responsibilities are fixed, and they are a function of its 1997 plant investment. It makes no sense whatsoever under cost causation principles to allocate that portion of the tax on the basis of kWh deliveries in 2009. There is a direct and undeniable causal connection to historical plant in service that should be recognized. That causality is recognized in IIEC's proposed allocation approach.

D. Rate Moderation

In this case, IIEC has proposed a rate moderation plan similar to the one approved in the recent *Ameren Cases*. Specifically, IIEC proposes that the increase to any delivery service rate class or subclass be limited to 150% of the overall revenue increase, inclusive of the impact of the IEDT approved for ComEd. (Stephens, IIEC Ex. 2.0-C at 3-4:46-57; 7-8:168-204). IIEC's recommendation should be adopted for the reasons stated below.

Rate moderation and avoidance of rate shock is an important principle of proper utility rate design. The Commission has recognized the importance of that principle in its recent decisions in the *2009 Ameren Cases* and in the last ComEd rate case, *Re: Commonwealth Edison Company*, Dkt. 07-0566, Final Order, September 10, 2008. In the *2009 Ameren Cases*, the Commission stated:

[M]itigation strategies serve an important role in promoting rate continuity and rate stability while considering potential bill impacts that could result as rates are moved toward the actual cost of service.

* * *

It is a widely held ratemaking policy that rates should be designed to reflect cost causation, maintain gradualism, and avoid rate shock. (2009 Ameren Cases, Final Order, April 29, 2010 at 287, 295).

In its decision in the last ComEd rate case, the Commission addressed rate moderation in two ways. First, when it refused Staff's proposal for an across-the-board increase (i.e., system average increase for all customers), because it allowed no movement toward alleged cost of service, it moderated selected class rate changes. (*Re: Commonwealth Edison Company*, Dkt. 07-0566, Order, Sept.10, 2008, Final Order at 213). In recognition of deficiencies in the ComEd ECOS studies, the Commission moderated the increase to the classes that would be most adversely affected by movement to the flawed cost determination. The Commission explained:

Therefore, we accept ComEd's ECOSS with the following modification. Above, we determined that the proper assignment of primary and secondary distribution costs would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage, and Railroad delivery classes. It would be inconsistent with that finding to accept ComEd's two-step rate increase. Instead, an allocation that more closely reflects a proper cost of service would be reflected in a four-step, gradual movement toward rates based on the ECOSS for Extra Large Load, High Voltage, and Railroad Delivery Classes. ComEd Ex 30.0 at 43-45. Thus, the Commission authorizes a 25% movement toward ECOSS based rates for these customers, instead of a 50% movement. (*Id.* at 213).

The second way the Commission recognized the need for rate moderation was in its use of percentage deviations from the system average increase as a measure of rate impact. In its discussion of the Railroad Class, the Commission essentially defines rate shock in terms of increases in multiples of the ComEd system average increase. The Commission stated:

In this case, ComEd originally proposed rates for the railroad class that were **more than five times that of the general increase**. Even under its mitigation plan, the proposed rates for the railroad class are **three times higher than the general increase**. Thus the ECOSS, which the Commission has found to be inaccurate in several respects relevant to the railroad class, directly conflicts with our finding in Docket 05-0597 that **minimizing rate shock** to railroad customers is in the public interest.” (*Id.* at 223, emphasis added).

These recent decisions show that the Commission, 1) recognizes the importance of rate moderation and avoidance of rate shock, and 2) uses percent of overall increase as an indicator of rate shock. In the *2009 Ameren Cases*, the Commission limited the increase for any class to 150% of (1.5 times) the utility average increase, as proposed by Staff and IIEC, including the impact of the Public Utilities Revenue Act (PURA) tax (referred to as IEDT in this case). The Commission also agreed with IIEC’s specific recommendation to apply that rate moderation at the subclass level, since customer impacts are more related to subclass changes more than to full rate class changes.

IIEC recommends that rate moderation be implemented at the subclass level. Given the concern over the impact of the change in the PURA tax allocation, the Commission is inclined to agree. Moreover, IIEC has expressed its willingness to accept Staff’s rate mitigation approach if it is applied at the subclass level. The Commission sees no reason why Staff’s proposal based on a 150% increase limit could not be applied at the subclass level, as suggested by IIEC. (*2009 Ameren Cases*, Final Order, April 29, 2010 at 295).

In addition, applying rate moderation at the subclass level provides relief where needed, and only where needed.

In the current case, IIEC is the only party that has addressed rate moderation in a manner consistent with the Commission’s recent determinations. ComEd only proposed gradual movement toward cost of service, without regard to the specific bill impact. Staff, on the other hand, ignores

altogether the issue of rate moderation in this case, despite its proposal for (and Commission approval of) rate moderation in the *2009 Ameren Cases*. Staff's focus appears to be exclusively movement toward cost of service, without regard to rate moderation or avoidance of rate shock for any class. (*See generally* Boggs, Staff Exs. 13.0 and 29.0-C). However, IIEC witness Stephens took account of the Commission's policies and referencing the ELL, HV and Railroad delivery classes, pointed out that:

It is important that protections be put in place to ensure that undue rate impacts are avoided with respect to all rate classes, not just the three classes mentioned above. Accordingly, and consistent with the Commission's recent decision involving the Ameren Illinois Utilities, in Docket No. 09-0306, *et al.*, I recommend that the Commission approve a rate moderation plan whereby no customer class or sub-class experiences an increase in delivery charges of more than 150% of the overall ComEd revenue increase, inclusive of the impact of the Illinois Electricity Distribution Tax '(IEDT)'. For example, should the Commission approve a 20% increase in ComEd's delivery revenues in this case, no class or sub-class should receive an increase greater than 30% (20% x 1.50). (Stephens, IIEC Exhibit 2.0-C at 2-3:46-57).

The Commission's four-step movement toward cost of service for the ELL, HV and Railroad classes, discussed in Section VIII.C.4.a. below, is insufficient protection against rate shock. Further, it applies only to three ComEd rate classes. As it did in the *2009 Ameren Cases*, the Commission should recognize here the importance of the policy of rate moderation, without regard to which customer classes may need the protection. Customer classes that experience unduly large delivery service increases, i.e. more than 150% of the overall ComEd increase, should receive protection, regardless of the identity of the particular rate class.

Rate moderation is best applied at the highest level, without foreknowledge of which customer classes may be affected. Because the rate impacts depend on many Commission determinations related to revenue requirements, cost of service, and rate design, it is impossible to know now which rate classes and subclasses may require rate moderation. It is possible that Commission decisions in these areas make application of this rate moderation protection minimal or moot. However, the Commission should approve this improved rate moderation to provide a level of protection, should a combination of Commission decisions have large impacts on any particular rate class or subclass. (Stephens, IIEC Ex. 2.0-C at 8:199-204).

Implementation of IIEC's rate moderation plan will be relatively straightforward, as it was in the *2009 Ameren Cases*. Mr. Stephens explained the approach for determining the applicability to classes and subclasses, once the decisions about revenue allocations are known, and the necessary spreading of cost recovery among customer classes, if needed. (Stephens, IIEC Ex. 5.0-C, at 17-19:386-438). Consistent with its orders in the *2009 Ameren Cases* and the ComEd rate case in Docket 07-0566, the Commission should recognize the need for rate moderation and avoidance of rate shock, and should approve the rate moderation plan proposed by IIEC in this case, as outlined above and in the testimony of IIEC witness Stephens.

VIII. RATE DESIGN

B. Potentially Uncontested Issues

1. High Voltage Rate Design Simplification

ComEd has proposed to simplify the rate design for the High Voltage ("HV") delivery service rate class by reducing the number of charges applicable to this rate class. (Alongi, ComEd Ex. 16.0

3rd Rev. at 14-16:291-343). Specifically, ComEd proposes to reduce the current list of six possible customer charges and six possible standard metering service charges to a single customer charge and a single metering charge. (*Id.* at 14:291-293).

In addition, ComEd proposes to reduce the list of possible DFC charges for HV customers from five to three. ComEd proposes a single DFC for all load entering the customer's premises at voltages below 69,000 volts ("69 kV") and two DFCs for all load entering the customer's premises at or above 69 kV. The first of the latter two DFCs would be applicable if the customer's highest 30-minute demand, for the last 12 monthly billing periods, exceeded 10 MW. The second of the two DFCs would apply if the customer's highest 30-minute demand for the last 12 monthly billing periods did not exceed 10 MW. (*Id.* at 14:295-300).

IIEC has no objection to these rate design changes. (Stephens, IIEC Ex. 2.0-C at 10:234-235).

C. Potentially Contested Issues

3. Class Definitions

b. New Primary Voltage Delivery Class vs. Primary Subclass Charges

In Docket No. 08-0532, the Commission recognized the value in distinguishing the costs imposed by primary customers – customers who receive service at 4,000 volts ("4 kV") and above -- from those imposed by secondary customers, who receive service at below 4 kV.

Our concern [in Docket 07-0566] was that although the vast majority of ComEd's customers take service at lower voltages that utilize its extensive distribution system, a small number of customers take service at higher voltages that bypass significant portions of the distribution infrastructure. Their cost of service is therefore lower on

a per kilowatt basis. The rates charged to these primary system customers should reflect this lower cost of service.

* * * *

Consistent with the foregoing, we direct ComEd to develop and provide in its next rate proceeding: ... 5) consideration of redefining rate classes on the basis of voltage or equipment usage to better reflect the cost of service. (RDIO at 35, 40).

Ultimately, the Commission's Findings and Ordering Paragraphs in the RDIO gave ComEd very clear direction as to what was required in this rate case.

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:
....

(4) the following decisions are final and should be reflected in the ECOSS for consideration in any subsequent action in the Company's next rate case:

- a) customers receiving power at 4kV or higher are primary system customers who should be identified. Rates charged to these customers should be adjusted to reflect that they do not use the secondary distribution system;
- b) customers receiving power at levels below 4kV should be considered secondary system customers and charged accordingly; (RDIO at 84) (emphasis added).

Plainly, a rate design that does not differentiate between primary and secondary customers' costs does not comply with the Commission's RDIO directives. ComEd's proposed rate design does not make such a differentiation. This failing must disqualify ComEd's proposed rate design (Alongi, ComEd. Exs. 16.2, 49.1 and 73.1) and the associated Proposed ECOS studies (Heintz, ComEd Ex. 15.1, 51.1 and 75.1) from adoption in this case.

Besides IIEC's rate design, this leaves ComEd's Preferred Exemplar (ComEd Exs. 49.2 and 73.2) and its Alternative Exemplar (ComEd. Exs. 49.3 and 73.3) rate designs. The Commission must determine whether (a) to adopt a new rate class composed of primary customers from each of ComEd's traditional, size-differentiated delivery classes (leaving only secondary customers in the existing classes) or (b) to create sub-classes within the existing classes to distinguish primary and secondary customers, with distinct DFCs for primary and secondary customers. These choices are represented respectively by (a) ComEd's Preferred Exemplar rate design and (b) IIEC's rate design and ComEd's Alternative Exemplar rate design. As noted in Section VII.C.1.(iii) above, ComEd favors a new primary class (PVD) over IIEC's less disruptive creation of distinctive DFCs within the existing ML, LL, VLL and ELL rate classes. (Alongi, ComEd Ex. 49.0 Rev. at 6:138-140). ComEd's "Alternative Exemplar" approach (Alongi, ComEd Ex. 73.3) is similar to IIEC's approach, except that ComEd's approach would establish separate DFCs for the Small Load delivery class and separate transformer charges for transformation between two primary voltages.²³ (Alongi, ComEd Ex. 73.0, 2nd Rev. at 5:120-127; Stephens, IIEC Ex. 5.0-C at 24:551-555).

Under IIEC's proposal, only DFCs would be affected and any change in ComEd's approved revenue requirement would be reflected in the DFCs. IIEC's proposal is a simpler and better approach to implementation of the Commission's directive to present voltage differentiated rates, as it is less disruptive to customers. Specifically, no new classes are needed, customers remain in

²³ There currently are no separate transformer charges. The cost of transformers is collected through the DFC. That approach would not change under IIEC's recommended rate structure. ComEd's preferred and alternative exemplar rate structure, however, would separate transformer costs and charge them separately. (See, Alongi, Com Ed Ex. 73.0, 2nd Revised, at 27:601-604).

their existing classes, and only the DFCs paid by customers would change. (DFCs would change in this rate case in any event). All of the customers in a particular rate class would pay the same customer charge, meter charge and IEDT charge (if applicable). Only the DFC for these customers would differ, depending on whether they were in the primary subclass or the secondary subclass. (IIEC Ex. 2.0-C at 16-18:386-446; IIEC Ex. 5.0-C at 23-24:518-555).

In contrast, ComEd's Preferred Exemplar rate design, with its novel PVD class, requires creation of a new customer class and redefinition of five existing customer classes. The new primary class improperly groups customers of different sizes and usage characteristics, which is counter to traditional rate design. Also, as pointed out by ICC Staff, this proposed "one-size-fits-all" approach is also inconsistent with ComEd's approach for customers served at secondary voltage and customers served at high voltage. (Stephens, IIEC Ex. 2.0-C, 14-15:360-380; Lazare, ICC Staff Exhibit 10.0, at 32-33:749-784).

To the extent that the facilities used to provide service to customers taking service at primary are likely comparable among customer classes, as claimed by ComEd (Alongi, ComEd Ex. 49.0 Rev. at 30-32:685-712), the same would be true for secondary customers. Yet, ComEd has maintained, since its initial delivery service rate case, that size differentiation must be maintained to recognize the different usage patterns and (presumably) cost of service characteristics of different size customers. Thus, ComEd's exemplar PVD class in its Preferred Exemplar rate proposal would result in inconsistent treatment of customers in this regard. (Stephens, IIEC Ex. 5.0-C, at 28:617-624). ComEd's approved rate design should continue to recognize both the size and cost differences among customers in the existing non-residential rate classes. IIEC's proposed rate design

accomplishes those objectives by retaining the existing size-differentiated customer classes and establishing separate, cost-distinguished DFCs for primary and secondary customers within the ML, LL, VLL and ELL rate classes.

If the Commission does not approve IIEC's recommended rate structure, under no circumstances should it approve ComEd's proposed rate structure. Instead, IIEC suggests that a less cost driven (but acceptable) alternative would be to use ComEd's Alternative Exemplar rate design, illustrated in ComEd Exhibits. 49.3 and 73.3, with the associated rates themselves modified to reflect IIEC's rebuttal ECOS Study. (Stephens, IIEC Ex. 5.0-C at 25:558-561, 26-27:570-586, 29:625-637). As mentioned above, under no circumstances should the Commission adopt ComEd's Proposed rate design structure, which does not comply with the Commission's RDIO directive, to recognize voltage differences. Similarly, the Commission should not adopt ComEd's PVD class structure. That proposal places primary customers with significantly different costs of service in one rate class, and it introduces unnecessary complications. (Stephens, IIEC Ex. 2.0-C at 14-15:348-364).

4 Non-Residential

a. Movement Toward ECOSS Rates

For the purposes of its brief, IIEC treats items (i) and (ii) below as a single issue. Furthermore, IIEC considers this topic of movement toward ECOSS rates to be a revenue allocation matter, not a rate design matter even though it is addressed in the Rate Design section of this brief.

- (i) **Extra Large Load and High Voltage Customer Classes
and**
- (ii) **Railroad Customer Class**

ComEd proposed to continue the four-step movement toward cost based rates for certain classes, as directed by the Commission in Docket 07-0566. Specifically, ComEd proposed to move the ELL class and the HV classes toward cost of service (as measured by its ECOS studies) by adjusting the DFCs for those rate classes. Rates for those classes, which are allegedly below cost, would move upward by 33% as the second step in the Commission's four-step process. (Alongi, ComEd Ex. 16.0 3rd Rev. at 12:239-261). IIEC supports the continuation of the four-step movement toward cost.

The order in Docket 07-0566 established a four-step process to move the ELL, HV and Railroad delivery classes' rates toward cost of service, primarily due to the Commission's doubts about the validity of ComEd's cost of service study in that case. Because the Commission recognized the likelihood that ComEd's proposed cost of service for these classes was overstated, it was unwilling to move more rapidly toward the wrong end point. *Re: Commonwealth Edison Company*, Dkt. 07-0566, Sept. 10, 2008 Final Order at 213.

ComEd filed rates in this case that seek to comply with the Commission's four-step directive in that case. In response to a claim by Staff witness Boggs suggesting that ComEd's proposal is inconsistent with the approach approved by the Commission, ComEd witness Alongi stated:

The mitigation mechanism ComEd employs in its proposed and exemplar rate designs in this proceeding is exactly the same as the mitigation mechanism that it used to develop the rates ComEd filed on September 12, 2008, in compliance with the Commission's Order in Docket No. 07-0566. Those rates and the associated work papers that developed those rates were reviewed and accepted by the

Commission's Staff.”
(Alongi, ComEd Ex. 73.0 2nd Rev. at 6:144-149).

Staff proposes to deviate from the Commission's process by moving rates additional increments toward cost of service – above the 33% that is mathematically the first of three remaining steps in the Commission's four-step process. As IIEC understands Mr. Boggs' proposal, he would begin with ComEd's proposed rates, which already reflect 33% movement toward alleged cost (at full revenue request) for the ELL and HV classes and 10% movement toward cost for the Railroad class, and would then move the ELL and HV revenues an additional 33% toward alleged cost and move the Railroad revenues an additional 25% toward alleged cost. (Boggs, Jan. 13 Tr. 1217-1218; Boggs, ICC Staff Ex. 29.0C at 5:96-102; Boggs, Schedule 29.01-C at 1). Thus, for the ELL and HV classes, Mr. Boggs would essentially be taking the second and third steps of the Commission's four-step process at once.²⁴ (Stephens, IIEC Ex. 5.0-C at 9:209-211; See also, Alongi, ComEd Ex. 49.0 Rev. at 9-10:217-222). He would thereby turn the Commission's previously approved four-step process into a three-step process for the ELL and HV classes and some indeterminable number of steps for the Railroad classes.

IIEC witness Stephens testified that the existing four-step process should be continued, moving the rates of the ELL and HV classes, 33% of the way from current revenues to cost of service, as measured by IIEC's rebuttal ECOS Study.²⁵ (Stephens, IIEC Ex. 2.0-C at 4-8:104-204; Stephens,

²⁴ Considering that his rate recommendation is based on ComEd's faulty ECOS Study and its full rate request (which is unlikely to be approved), Mr. Boggs is actually recommending movement *somewhat more than* just the second and third steps.

²⁵ As IIEC witness Stephens recommended application of this approach for protection of the Railroad delivery class; but IIEC will defer to the Commission's judgment on its preferred

IIEC Ex. 5.0-C at 3-19:59-438). This approach does not necessarily advantage the ELL and HV classes or subclasses. Depending on the Commission's determinations on customer class structure, P/S split issues, and allocations of various cost of service items such as primary lines and substations and the IEDT, one or more of the subclasses may be entitled to a larger rate decrease under movement to cost of service. (Stephens, IIEC Ex. 2.0-C, at 18:432-440). Despite this potential, IIEC does not disagree with maintenance of the Commission's four-step process.

(iii) Spreading of Revenue Shortfall Due to Limited Movement to Cost-Based Rates or Rate Moderation

Any time a delivery class' rates produce revenues at a level different from its cost of service, that class is creating either a revenue surplus or shortfall and, to the extent the surplus or shortfall is spread among classes, that affects other customer classes. This is a common byproduct of rate design mechanisms that address rate moderation or avoidance of rate shock. (Stephens, IIEC Ex. 5.0-C at 18:419-420). Some consider this a rate inequity. In the last ComEd rate case, the Commission recognized the potential for rate inequity to be created, but acknowledged that determining the existence of a rate inequity is fully dependent on knowing the classes' actual cost of service, determined through a valid cost of service study. In this regard, the Commission stated:

What is unclear, and will remain unclear until an ECOSS is evaluated in compliance with our findings above,²⁶ is how significant the rate inequities are under this ECOSS.

(Re: Commonwealth Edison Company, Dkt. 07-566, Sept. 10, 2008

treatment of the Railroad delivery class.

²⁶ The Commission's "findings above" refers to items such as a proper split of primary and secondary costs, as generally discussed at pages 205-213 of its Order.

Final Order at 213).

In the same order, the Commission established its gradual four-step process for adjusting rates of the ELL, HV and Railroad delivery classes (discussed in the previous section of this brief) as movement part way to ComEd's computation of class costs (without fully approving ComEd's ECOS study). According to ComEd, when it designed rates in this case, as in its computation of "compliance" rates from the last case, it began with its own ECOS study results. (Alongi, ComEd Ex. 73.0 2nd Rev. at 6:144-149). In cases where proposed rates do not collect full cost of service, such as with the ELL, HV and Railroad classes, ComEd proposes to recover those costs from other demand-based non-residential classes. (Alongi, ComEd Ex. 16.0 Revised at 28:510-515).

In this case, there are two primary cost allocation and rate design objectives that could require spreading of revenue shortfalls among classes. First is the aforementioned Commission-designed limitation on movement toward cost of service for the ELL, HV and Railroad classes. When and if the Commission identifies a correct cost of service study in this case, it will be possible to determine how the existing revenues from the ELL, HV and Railroad classes compare to cost and thus, determine the extent to which the Commission's four-step movement toward cost of service for these classes will require a revenue shortfall to be spread to other classes. Second is rate moderation, a principle applicable to all customer classes, designed to protect against rate shock. (*See* Section VIII.D.above). As mentioned in the Rate Moderation section of this brief, once the Commission has decided various issues related to revenue requirements, rate class structures, cost allocation, and rate design, it may be necessary to moderate rates. (Stephens, IIEC Ex. 2.0-C, at 8:197-204; Stephens, IIEC Ex. 5.0-C, at 15-16:363-375). If this occurs, it will be necessary to spread revenue requirement

shortfalls to other classes that would not experience rate shock. (*Id.* at 16:376-380).

IIEC witness Stephens explained that if such spreading of revenue shortfalls is necessary, the Commission should direct that they be spread to other classes on a *pro rata* basis, based on total class revenues. To the extent that the redistribution of revenue requirement to a class would cause it to exceed the maximum moderated revenue increase, such amounts should be spread to remaining classes that have not been maxed out. (*Id.* at 18:412-418).

5. Collection of Illinois Electricity Distribution Tax

ComEd proposes to establish a separate charge on each customer's bill for the IEDT. (Alongi, ComEd Ex. 16.0 3rd Rev at 18-19:386-406 and 19-23:408-329). ComEd reasons that the IEDT is imposed upon ComEd on the basis of kWh delivered and, therefore, apparently better collected through a separate per kWh charge on each customer's bill. (*Id.* at 18:391-394). IIEC disagrees with ComEd's factual premise and with its proposed rate design change.

ComEd currently collects the IEDT in base rates through applicable delivery service charges for each customer class. (Fults, REACT Ex. 1.0-C at 28:683-689). ComEd has not demonstrated why this particular element, of all the similar elements of its overall cost of service, must be identified separately and recovered through a separate per kWh charge on each customer's bill.

The tax in question is imposed directly on ComEd, not on its customers. (Stephens, IIEC Ex. 2.0-C at 10:255-256; Stephens, IIEC Ex. 5.0-C at 22:510-512). ComEd witness Alongi appears to recognize this fundamental fact when he testified: "The Illinois Electric Distribution Tax is imposed upon ComEd. . . ." (Alongi, Comd Ex. 16.0 3rd Rev. at 18:401). The IEDT is paid by ComEd, not its customers; here, ComEd is not the collector for a tax on customers. In this regard, the IEDT is

similar to sales taxes, income taxes, property taxes and other taxes imposed on ComEd. (Stephens, 2.0-C at 10:255-256). Such taxes are reflected in ComEd's overall cost of service. (*See e.g.*, ComEd. Ex. 6.2, WPC-18 at 1, Lns. 4, 10, 11 and 12), and, collected along with all of ComEd's other prudent and reasonable costs, in its existing delivery service charges. (Fults, REACT x. 1.0-C at 28:683-689). Absent some legitimate reason for culling this particular cost from the herd of ComEd costs now collected in ComEd's existing rates, the IEDT cost should continue to be collected in ComEd's existing rates, through its existing delivery service charges. ComEd has yet to identify any reason to change this element of rate design.

ComEd has offered only one justification for separately identifying this particular cost and collecting it through a separate per kWh charge on each customer's bill. ComEd witness Alongi testified that ComEd proposed this rate design change because it was his "understanding" that the IEDT is imposed on ComEd on the basis of kWh delivered. (Alongi, ComEd Ex. 49.0 Rev. at 17:387-390). Unfortunately, that "understanding" is actually a misunderstanding of the IEDT, its history, and the factors that actually determine the amount of tax paid by ComEd each year. IIEC has explained that history and identified the factors that actually determine the amount of tax ComEd pays each year in Section VII.C.1.h. above. In sum, IIEC has demonstrated that the tax is not exclusively or primarily a function of kWh delivered by ComEd in any given year, as Mr. Alongi assumed. Therefore, ComEd's proposed rate design change has no basis in the evidence of record and should be rejected. The IEDT should continue to be collected in base rates and through existing delivery service rate charges for each delivery service rate class -- the way ComEd collects its other prudent and reasonable operating costs.

6. Distribution Loss Factors

ComEd originally presented a distribution loss study in this case that produced questionable results in relation to the High Voltage Delivery Class. The Department of Energy (“DOE”) presented testimony in this case that suggested that ComEd’s proposed distribution loss factor for the HV delivery service class (1.93%) significantly overstated the actual distribution losses for that class. Specifically, DOE presented evidence demonstrating that distribution losses for customers served at 138,000 volts (“138 kV”) or higher, are effectively zero. (Etheridge, DOE Ex. 1.0 at 7:17-24; Patterson, DOE Ex. 2.0 at 4-5:24-25, 1-4). In addition, DOE witnesses pointed out a number of issues relating to the reasonableness of the documentation supporting the development of key inputs used to calculate the proposed distribution loss factors for HV customers. Specifically, ComEd was not able to document the transformer losses used to derive load-related and no-load transformers losses applicable to the HV delivery class. (*See*, Patterson, DOE Ex. 4.0 at 2-3). IIEC witness Stephens agreed with DOE witnesses Etheridge and Patterson. (Stephens, IIEC Ex. 5.0-C at 33:714-718).

In rebuttal ComEd took steps to address these concerns. (Etheridge, DOE Ex. 3.0 at 3:3-7, 4:17-21; Stephens, IIEC Ex. 5.0-C at 33-34:719-733). On rebuttal, ComEd proposed to recognize that customers served at 138 kV or higher voltages caused essentially zero distribution losses, by providing updated distribution loss factors applicable to customers with service points at which electricity is metered at 138 kV or higher. Specifically, ComEd will determine and apply weighted average distribution loss factors for all points of delivery for the 18 HV accounts with one or more points of delivery metered at 138 kV or higher. (Alongi, ComEd Ex. 49.0 Rev. at 50:1117-1126).

ComEd also revised its distribution loss study to correct the estimates of load related and no-load losses associated with transformers used to supply electricity to customers in the HV class. This last change lowered ComEd's 2009 distribution loss study factor for customers in the HV class metered at 138 kV or higher, from 1.93% to approximately 0.9%. (Stephens, IIEC Ex. 5.0-C at 33:726-729).

However, IIEC witness Stephens also pointed out that in estimating the transformer losses, ComEd used a simple average of the "no load" and "full load" loss percentages for those transformers, where such percentages were known. However, the MVA capacity of the subject transformers varies considerably. (Stephens, IIEC Ex. 5.0-C at 34:743-748). Under such circumstances, the simple average of no load and full load loss percentages puts the same weight on loss percentages associated with small MVA transformers as it does on the loss percentages for the large MVA transformers, even though larger transformers have a greater impact on ComEd's actual distribution losses. (*Id.* at 34-35:748-751). Use of a simple average skewed the results of ComEd's analysis. Therefore, IIEC recommended the average of no load and full load loss percentages for the subject transformers be calculated as an MVA-weighted average. (*Id.* at 35:753-755).

In its surrebuttal testimony, ComEd accepted Mr. Stephens' recommendation and calculated its distribution loss factors using the MVA-weighted full load and no load loss percentages. (Born, ComEd Ex. 67.0 Rev. at 3:53-59). IIEC agrees with ComEd's adjustment and the resulting distribution loss factors for HV customers.

In summary, ComEd has adequately addressed IIEC's concerns about the distribution loss factors for High Voltage customers.

X. OTHER

C. Updated Distribution Loss Study

See IIEC's discussion in Section VIII.C.3.b. above.

XI. CONCLUSION

For the reasons stated herein, IIEC respectfully requests that the Commission adopt the recommendations made by IIEC herein.

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