STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	)	
	)	
Petition for approval of an Alternative Rate	)	Docket No. 10-0527
Regulation Plan pursuant to Section 9-244	)	
of the Public Utilities Act	)	

INITIAL BRIEF OF THE CITIZENS UTILITY BOARD

Kristin Munsch, Attorney
Christie Hicks, Attorney
CITIZENS UTILITY BOARD
309 W. Washington, Suite 800
Chicago, Illinois 60606
Telephone: 312-263-4282
Fax: 312-263-4329
kmunsch@citizensutilityboard.org
crhicks@citizensutilityboard.org

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NOW COMES the Citizens Utility Board ("CUB"), pursuant to Section 200.800 of the Rules of Practice, 83 Ill. Adm. Code Part 200, of the Illinois Commerce Commission ("ICC" or "the Commission") and the briefing schedule established by the Administrative Law Judges ("ALJs") in this case, to file this Initial Brief. This proceeding concerns a request for an alternative regulation plan filed by Commonwealth Edison Company ("ComEd" or "the Company"). This brief addresses the factual and legal issues raised by the evidence of record and by the application of the controlling provisions of the Public Utilities Act (the "Act" or "PUA"), 220 ILCS 5/101 *et seq.*, and relevant Illinois case law to the circumstances of this case. CUB presented the testimony of Christopher C. Thomas in this case, which addressed the policies implicated by ComEd's proposal, in CUB Exhibits 1.0-1.4 and 2.0.

I. INTRODUCTION

ComEd is proposing what it calls an "alternative regulation pilot plan" ("the Proposal") pursuant to Section 9-244 of the PUA. ComEd Petition at 1. This plan is an alternative cost recovery mechanism, Rate ACEP, which would recover the costs of four specific investments:

- An accelerated Urban Underground Facility Reinvestment program;
- A pilot of electric vehicles in utility operations;
- A Low Income Assistance Program; and

- Any potential future deployment of "smart grid" technologies such as advanced metering and distribution automation. *Id.*

ComEd's proposal is not one that satisfies the criteria set forth in Section 9-244 – in short, it is not a request for alternative regulation but a proposal to pilot the piecemeal recovery of isolated program costs through a new rate on top of continuing, "traditional regulation." The projects ComEd has proposed are discretionary, and similar project investments have been made by the Company and evaluated under traditional regulation. Rate ACEP benefits ComEd shareholders by shifting costs and risks associated with proposed future investments in the specific, discretionary projects ComEd proposes. This one-sided proposal is not the win/win approach that ComEd portrays it to be. Rate ACEP is poor regulatory policy which is little more than a repackaging of the Company's previously submitted – and rejected – Rider SMP.

The Company expresses interest in moving away from traditional regulation, and is therefore interested in a "pilot" alternative regulation scheme as a first step away from traditional regulation. ComEd Ex. 1.0 at 4-5. True alternative regulation would involve creating performance metrics to ensure the Company invests wisely to benefit customers while meeting its statutory obligation to provide "adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens." CUB Ex. 1.0 at 18-19, citing 220 ILCS 5/1-101. The key characteristics of alternative regulation should be transparency and accountability. There should be an

open, collaborative process designed to facilitate information sharing with minimal administrative burdens which includes opportunities for ongoing evaluation of utility investment performances. CUB Ex. 1.0 at 19-20. It should provide an incentive to for cost-efficient investments that provide the utility with incentive to maintain a level of investment that focuses on providing safe and reliable service over there long-term, with continuing improvements and long-term cost reductions. *Id.* Most importantly, the Commission should have a clear standard by which to measure a proposal's success or failure, such as an overall reduction in customer bills and improvements in customer service (reliability improvements, reduction of billing errors, and improved customer access to data). *Id.*

ComEd's proposal does not have any of these characteristics. It does not meet the statutory criteria under the PUA for appropriate alternative regulation. Since ComEd's Rate ACEP proposal will be equally burdensome from a regulatory standpoint, will result in costs higher than those under traditional regulation, and will focus on discretionary projects that the Company could already pursue, the Commission should reject the proposal.

II. RATE ACEP PROPOSAL

A. PROPOSED RATE ACEP MECHANISM

ComEd proposes a "mechanism" with two principal components that are bundled together so that the benefits claimed from new programs are only offered upon

Commission approval of special rate recovery outside of rate cases under Rate ACEP. AG Ex. 1.0 at 14. ComEd proposes a plan for advance regulatory review, including a review of the prudency of the proposed project, of its "investment decisions

After receiving this pre-approval, Rate ACEP will recover the costs of these programs as they are incurred outside of the normal rate case process. CUB Ex. 1.0 at 5. ComEd Ex. 1.2 is a 21-page proposed tariff that describes the filings, review processes and rate changes would result from approval of Rate ACEP. According to ComEd witness Dr. Ross Hemphill,

> …the proposal provides for continuing input by stakeholders and two levels of commission review. The Commission reviews and approves all deployments and the corresponding capital and O&M budgets in advance. The Commission will also hold formal biennial review proceedings, as long as the alternative regulation tariff remains in effect, to review, modify, and adapt the programs conducted under its auspices. ComEd Ex. 1.0 at 6.

In its responses to data requests AG 1.13 and DLH 6.02, ComEd listed and described the filings and procedures it envisions for administration of Rate ACEP. CUB Ex. 1.2 and 1.3. The proceedings begin with informational filings documenting the initial ACEP charges from the date of the ICC order in this case, and include biennial review proceedings to approve programs whose costs would be recovered through Rate ACEP. *Id.*

ComEd has attempted to estimate the costs of the proposed projects. ComEd Exhibit 1.3 is a summary of the projected investment, O&M and Rate ACEP recovery amounts. Based upon these illustrative calculations and the underlying assumptions,

ComEd customers would be charged $4.4 million to $5.2 million per calendar quarter, on top of base rates approved by the Commission in traditional regulation, with cumulative charges through January of 2013 totaling $24.1 million. Id. Actual costs incurred by the Company and passed along to customers would depend upon the timing of Commission approval of programs and ComEd's rate of actual spending. AG Ex. 1.0 at 16. Charges through Rate ACEP would continue and grow until ComEd's next base rate case provides an opportunity to include the cumulative investments within test year approved utility rates. *Id.* The Company admits itself if there is a question as to whether under Rate ACEP customers would end up paying a little bit more than what it costs ComEd to implement any given project, the answer is yes. Tr. at 463. Moreover, the Company has predicted use of Rate ACEP upon a favorable outcome in its case requesting approval of an increase in delivery services rates:

> Because this alternative regulation plan contemplates ComEd investing additional capital of up to 130 million and incurring additional O&M expenses up to 65 million it is necessarily a condition on ComEd receiving approval of rates that give it a reasonable opportunity to recover its other delivery costs." Petition, Par. 15, Tr. at 615.

The Company offers Rate ACEP to the Commission as a "dual opportunity" to test the proposed technologies and the proposed regulatory framework. Tr. at 386. Dr. Hemphill characterizes the programs and costs selected by ComEd for Rate ACEP treatment as "discrete and discretionary," meaning they are not necessary at this time to provide safe and reliable service. ComEd Ex. 1.0 at 8-9; Tr. at 387. These are

investments the Company expects to produce "substantial customer benefits" that justify incurring the costs; but asserts that they would not be undertaken in the absence of pre-approval by the Commission and piecemeal cost recovery through Rate ACEP. ComEd Ex. 1.0 at 8-9.

Rate ACEP is an open ended tariff which provides for future expansion to include, "…any new or modified accelerated customer enhancement program proposed by the Company and approved by the ICC." ComEd Ex. 1.2, Original Sheet No. X+4 and Original Sheet Nos. X+12 and 13. ComEd proposes that there be continuing input from stakeholders, and biennial review proceedings to "review, modify, and adapt the programs conducted under its auspices." ComEd Ex. 1.0 at 6. There is no specific standard by which Rate ACEP proposed investments are evaluated, nor is there any end date to the rate plan itself. Tr. at 394. Instead, the only limitations on scope of Rate ACEP are limitations imposed by a collaborative proceeding – not dollar, not time, not benefit. *Id.* The tariff itself does not contain any other specific requirements on what projects could be approved beyond that which would be set out in a collaborative proceeding such as the size of the investment and the type of investment approved. Tr. at 395.

B. DESCRIPTION OF PROPOSED PROJECTS

ComEd has proposed four discretionary investments, three of which would begin immediately upon approval of the mechanism:

- An accelerated Urban Underground Facility Reinvestment ("UUFR") program;
- A pilot of Electric Vehicles ("EVs") in utility operations; and
- A Low Income Assistance ("LIA") Program.

CUB Ex. 1.0 at 3.

Although "there is nothing improper or imprudent" about its current pace of testing and replacing this cable, the purpose of the UUFR is to "accelerate and re-prioritize" ComEd's current process of testing underground mainline feeder cable to improve reliability. ComEd Ex. 4.0 at 2, 7.

The purpose of the second program, the EV pilot, is to gain information about electric cars in general. ComEd Ex. 2.0 at 3. ComEd has hybrid and hybrid plug-in vehicles, and will soon have all-electric vehicles as well, but seeks to purchase additional all-electric vehicles to increase the "sample size" of this type of car. Tr. at 184-86. While ComEd admits these electric vehicles might have environmental benefits, the Company states it must "pilot" the use of those vehicles to verify those benefits and determine whether it is prudent to deploy them for company use on a widespread basis.

The purpose of the third program is to continue administration of the low-income assistance programs ComEd currently has in place. ComEd currently administers several low-income assistance programs which were funded initially by shareholder funds and since 2007 by through the provisions of Public Act 95-0481 ("PA

95-0481"). Tr. at 340; ComEd Ex. 5.0 at 3. At the present time, ComEd and Exelon continue to fund at least part of the programs until now. Tr. at 348-351. However, ComEd will agree to continue administering these programs at this point only if Rate ACEP, which requires ratepayers to fund the programs entirely, is approved and if ComEd and Exelon contribute nothing. Tr. at 365.

The fourth program proposed by the Company is any future deployment of smart grid technologies, including Advanced Metering Infrastructure ("AMI") and Distribution Automation ("DA"). ComEd Petition at 6. The Company states that these plans and budgets will be proposed after completion of the AMI Pilot, the Illinois Statewide Smart Grid Collaborative ("ISSGC"), and the Commission's Smart Grid policy docket. CUB Ex. 1.0 at 3.

C. MECHANISM FOR FUTURE RATE ACEP PROJECTS

Section 9-244(c) requires a review two years after an alternative regulation program is first implemented to determine whether the program is meets its objectives and to make revisions if necessary. 220 ILCS 5/9-244(c). This review process would also address what projects should be allowed under Rate ACEP going forward. *Id*. For example, ComEd discusses smart grid investments at length in its testimony in this docket, but does not request recovery for that project at this time. Instead, it envisions Rate ACEP as a mechanism by which it could recover those investment costs in the future when specific smart grid projects are approved in the biennial review. *Id*. at 5-6.

ComEd is clear that this is not a reconciliation docket, as its costs would have been pre-approved in the instant docket. ComEd Ex. 1.0 Rev. at 24. Instead, it is strictly forward-looking, and the only review of the first two years of the projects is to evaluate actual vs. budgeted costs. *Id*. Rate ACEP does provide for an upfront determination of the prudency of a given investment. In fact, ComEd believes that just having Rate ACEP in place can make an "imprudent" investment in a discretionary project a "prudent" investment because the discretionary project costs recovered under Rate ACEP are no longer displacing essential activities. Tr. at 402, 404. ComEd's proposal also does not provide any post-hoc review of how investments are deployed, or indeed, even whether any decision to stop an investment was appropriate. This lack of a "used and useful" standard to review the scope, pace and completion of projects is troubling. For example, assume ComEd decides after spending three-quarters of its approved budget on electric vehicles that it no longer wishes to evaluate electric vehicles. ComEd could cease project investment without penalty, having recovered all of the costs it incurred for the program.

III. STATUTORY REQUIREMENTS

A. SECTION 9-244 OF THE PUBLIC UTILITIES ACT

1. Section 9-244 Requires that Alternative Regulation Must Result in Lowered Rates, Benefits to Customers, and Sharing of Economic Benefits

The most important task before the Commission is to evaluate the legality of ComEd's Rate ACEP under the alternative regulation framework provided for by the PUA, which spells out the specific findings the Commission must make in order to approve an alternative regulation proposal. 220 ILCS 5/9-244(b). The Company would prefer to debate the merits of the individual programs it has proposed rather than the legality of Rate ACEP. Tr. at 404. This comes as no surprise, considering the Company cannot legally justify Rate ACEP under Section 9-244. Unfortunately for ComEd, the law does not permit the Commission to simply overlook the legalities and evaluate the programs in a vacuum. While the Company would not like to "get bogged down with the intricacies of the statute and its application to what [they're] proposing here" (Tr. at 405), this evaluation must come before any evaluation of the individual projects they have proposed. Without a finding that Rate ACEP meets all of the requirements of 9-244, any details of the individual projects are irrelevant and Commission approval impossible.

Rate ACEP does not meet three key criteria of Section 9-244: It is not likely to result in rates lower than those that would otherwise have been in effect under traditional regulation for the projects covered by the program. The Company does not identify substantial benefits that would be realized by customers that they would not receive in absence of ACEP. The "sharing" mechanism proposed by the Company does not provide any net economic benefits to customers.

2. Finding Under 9-244(b)(1): ComEd's Proposal Will Not Result in Lower Rates

The PUA requires that in order to approve an alternative regulation plan, the Commission must find that the plan would result in rates lower than otherwise would have been in effect under traditional rate of return regulation for the services covered by the program and that are consistent with the provisions of Section 9-241. 220 ILCS5/9-244(b)(1). The evidence presented in this case shows just the contrary – in fact, ComEd has stated repeatedly that it would not undertake these projects under traditional regulation. ComEd Ex. 8.0 at 21. Even if the Company did so, the incentive put in place by Rate ACEP to inflate project budgets makes it more likely than not customers would pay less for the same investment under "traditional" rate case regulation. ComEd has argued that the 5% operations and maintenance expense ("O&M") discount is "all but certain" to reduce customer rates; however, the Company carefully makes the statute does not require that rates *will* be lower - only that they are *likely* to be lower. ComEd Ex. 6.0 at 40. ComEd's eagerness to make that distinction should raise red flags with the Commission: if the Company was truly "all but certain" that they met the criterion of (b)(1), would such fine distinctions be necessary?

The only evidence ComEd has offered to support a finding under (b)(1) is this proposed 5% O&M savings. The expense reduction is limited to $2 million. Staff Ex. 1.0R at 14. That limit applies not just to the projects proposed here but to all future costs recovered under Rate ACEP as well, which could include many other projects. *Id.* The Company argues that the savings are actually even greater than 5% because the budget includes "ascertainable operational savings." ComEd Ex. 1.0 Rev. at 19.

However, the Company has admitted that those "savings" are not measurable. Tr. at 418. Such savings, which the Company essentially asks the Commission to simply trust will be included in the calculation, are clearly not specific enough to meet the requirements of the statute. Moreover, ComEd alone has set the budgets for this "first generation" of Rate ACEP projects. Tr. at 400-401. As several parties have noted, this means ComEd alone determines whether it has met its targets based on its own budgets—providing great incentive for the Company to inflate budgets as much as possible. *Id.*, Staff Ex. 9.0 at 9, IIEC Ex. 1.0 at 11, AG Ex. 1.0 at 20, AARP Ex. 1.0 at 19. For just one example, Staff has shown that the budget of the electric vehicle pilot is significantly over-stated compared to what the Company is actually likely to pay. Staff Ex. 2.0 at 5-9.

It is true that Rate ACEP provides that if ComEd exceeds the O&M budget for a given project, customers will not pay the overage. ComEd Ex. 1.0 Rev. at 29. Therefore, ComEd has no incentive to go over its budget. However, ComEd also has no incentive to spend as little as possible to complete a project. The Company claims that because it would share the savings of work performed for less than 95% of the budget with customers, it has incentive to do so. That is not true. The Company sees much greater benefit from spending as much as it can to earn greater returns on those investments. If ComEd spends only 80% of its budget, it must share part of the savings with customers, and earns its return on a less-costly investment. If ComEd spends exactly 95% of its budget, it earns a greater return on its investment with no additional savings to be

credited to customers. In fact, if ComEd spends even 105% of its investment, it earns a return on that entire amount. ComEd Ex. 1.0 Rev. at 7. If ComEd spends even more, it can seek to recapture the shortfall in a rate case. Staff Ex. 8.0 at 16. The 5% O&M discount that ComEd points to as meeting (b)(1) is far from the definitive savings ComEd claims.

Under traditional regulation, part of the costs of an investment may be disallowed, so the Company has incentive not to over-spend on projects. However, under this scheme, the Company is encouraged to inflate the budget so that its investments are as large as possible, creating larger returns on those investments for the Company. Under Rate ACEP, ComEd does not have an incentive to restrain spending below what would occur for these projects under traditional regulation, and it is not likely that they would do so.

3. Finding Under 9-244(b)(2): Rate ACEP is Not Likely to Result in Substantial and Identifiable Benefits for Customers That They Would Not Realize in Absence of the Program

The PUA requires that an alternative regulation program be "likely to result in other substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program." 220 ILCS 5/9-244(b)(2). ComEd has not demonstrated "other substantial and identifiable benefits that would be realized by customers served under the program that would not be realized in the absence of the program" as required by the PUA. 220 ILCS 5/9-244(b)(2). The "program" here is not any specific project but the mechanism itself, Rate

ACEP. The Company readily uses Rate ACEP in general as "the program" to meet the criteria of (b)(1) and (b)(8). ComEd Ex. 6.0 at 39-40. While the specific projects proposed each have some benefits to customers, investing in them under Rate ACEP does not have any greater benefits than investing in them under traditional regulation. In fact, the projects proposed by ComEd have all been undertaken by the Company under traditional regulation in the past in different forms. This leads to the inescapable inference that in the absence of Rate ACEP, these projects would likely still occur in some form. A project by project review only highlights how these projects, while they might be discretionary, are by no means inappropriate or impossible under traditional regulation.

The Company already has a fleet of hybrid cars which were purchased under traditional regulation because of its own interest in the benefits of hybrid vehicles. AG Ex. 1.0 at 44, AG Ex. 1.5. Apparently the Company is now interested in the newer models of electric vehicles. ComEd will already receive eleven all-electric Chevy Volts through the Clean Cities Grant. Tr. at 184. The Company now claims that it needs more all-electric vehicles to get a sufficient "sample size." Tr. at 186. Based on its history of purchasing hybrid vehicles, and its stated intent to purchase all-electric vehicles without ACEP, the Company cannot contend that this project has benefits under Rate ACEP that would not be seen without this alternative regulation.

ComEd has been testing and replacing underground cable for many years. ComEd Ex. 4.0 at 6. A Company witness has testified that "there is nothing improper or

imprudent" about its current pace of testing and replacing this cable. *Id*. at 7. However, if it could undertake this investment under Rate ACEP, the Company could earn an immediate return on that investment rather than having to wait until its next rate case for that benefit. Tr. at 320. The Company explains that the benefit of UUFR is improved reliability for customers. *Id*. As Staff noted, if these improvements truly will improve reliability to the extent ComEd claims, then ComEd is being irresponsible by not undertaking this work in absence of alternative regulation. Staff Ex. 4.0 at 4. The Commission should not reward such behavior with alternative regulation. The greatest benefit to come then from instituting UUFR under ACEPT would seem a greater rate base investment – and higher return – for ComEd.

ComEd has had a low-income assistance program for years as well. AG Cross Ex. 4. The Company has had CARE programs since 2006, which at that time were funded using shareholder dollars. Tr. at 340. ComEd and Exelon continued to fund at least part of the programs. Tr. at 348-351. ComEd now states that it has not and will not contribute any further funding to low-income assistance programs. Tr. at 365. However, the Company will happily take the benefits of the goodwill engendered by offering a low-income assistance program with their name and logo attached, even though they contribute nothing. The Company's attempt to link continuation of low-income assistance to approval of Rate ACEP is opportunistic and inappropriate. Nothing about low-income assistance makes that program more likely to show benefits to customers under Rate ACEP than such a program would otherwise.

Rate ACEP, the program at issue in 9-244(b)(2), does not provide substantial and identifiable benefits to customers that would not be realized in absence of the program, because each of the projects proposed by ComEd under Rate ACEP can and has benefitted customers under traditional regulation. ComEd's apparent refusal to undertake these projects absent UUFR amounts to nothing more than a threat to the Commission to try to ensure alternative regulation, which results in no benefits other than to shareholders.

4. Finding Under 9-244(b)(8): Rate ACEP Does Not Include a Means to Share Economic Benefits Between the Company and its Customers

Section 9-244 requires that any alternative regulation proposal include "provisions for an equitable sharing of any net economic benefits between the utility and its customers to the extent the program is likely to result in such benefits." 220 ILCS 5/9-244(b)(8). Even if ComEd's proposed investments result in any economic benefits, Rate ACEP does not include a means to share those benefits with customers. The proposal is designed to provide full recovery, on a piecemeal basis, of all the incremental costs incurred by ComEd (with the dubious 5% "discount")—this is not savings sharing, but instead is a shifting of risk from the Company to shareholders. Economic benefits from each of the programs proposed are uncertain, and any economic benefits the programs do have would not be shared with customers until the Company's next rate case.

The company has pointed to three ways in which the "net economic benefits" of Rate ACEP are shared between the Company and customers. ComEd Ex. 1.0 Rev. at 32. First, they claim that 50/50 sharing of the carrying costs saved due to projects completed under budget meets the requirements of 9-244(b)(8). *Id*. at 19, 32. However, that assumes that the mechanism encourages savings—which it does not in fact do. As previously explained, Rate ACEP actually has incentives for the Company to overstate the budget, and then to spend the entire budget in order for the Company to see the greatest returns.

Second, the Company asserts that the benefit to low-income customers of the CARE program fulfills the (b)(8) requirement requires an extremely broad interpretation of the statute. ComEd Ex. 1.0R at 32. Reallocation of company revenues is not the same as sharing net economic benefits. The statute cannot be stretched to the degree the Company desires. It clearly does not envision that taking money from one group of customers and giving it to another group would qualify as "sharing" of economic benefits.

Finally, ComEd claims that customers will derive "other" benefits "from the greater flexibility and competitive opportunities that will ultimately result from the installation of smart grid technologies." ComEd Ex. 1.0R at 32. There is no proposal in this docket for approval of smart grid investments. The Company has been very clear on this point. They cannot claim that the Commission should consider benefits of a

project that might be proposed sometime in the future when determining the whether the current proposal meets the statutory requirements.

The Company has failed to show that any net economic benefits will even exist, much less that they will be equitably shared with customers. Instead, the Company has shown that it alone will retain economic benefits of making investments of larger size than they might otherwise under traditional regulation, due to overstated budgets, and that they will begin earning a return on those investments sooner than they would under traditional regulation.

In order for the Commission to approve alternative regulation, it must make specific findings that the Company has meet each of the eight requirements of 9-244. These findings must come before any evaluation of the specifics of the projects proposed under Rate ACEP. Because the Company has failed to meet three of the five requirements, (b)(1), (2) and (8), Rate ACEP cannot be approved.

IV. THE PURPOSE OF ALTERNATIVE REGULATION

A. THE TRADITIONAL REGULATORY FRAMEWORK

The Commission is charged with setting rates such that the Company can recover its reasonable and prudently-incurred costs and has an opportunity to earn a fair rate of return on its investments. CUB Ex. 1.0 at 12-13. Traditional regulation reflects the policy preference of encouraging utilities, such as ComEd to expand their distribution infrastructure by providing utilities with a distribution monopoly in their

service territory. *Id.* Because ComEd and other utilities have this monopoly, rates are regulated by the Commission as a substitute for the discipline of a competitive market. *Id*. at 13. The Commission's task is then to find an "equilibrium price" for service where the utility's total revenues cover their total costs and provide an opportunity to earn a fair rate of return. This is otherwise known as the Company's revenue requirement, and traditionally it is calculated as part of a "rate case" proceeding to adjust utility rates. The key characteristics of traditional rate case regulation include:

- A means for the utility to initiate a proceeding to review its delivery service rates, including its investments, and a means for the regulatory commission to initiate a review proceeding if the regulatory commission feels rates are too high. *Id*. at 12-13.
- A test year in which all of the components of the revenue requirement are analyzed and quantified in a balanced and consistent manner that matches total costs with total revenues over the same time period. This results in a prohibition against retroactive ratemaking so that rates are set for the purposes of looking forward, not rectifying past outcomes, or making up for lost or excess profits to reflect the costs of providing service going into the future. This also results in a prohibition against single-issue ratemaking so that no single cost change is considered without also considering the net result of all cost decreases and productivity changes. *Id*. at 12-13.

- Reviews of utility management decisions for prudency, based on the principle that a decision is reasonable if it can be justified given the information known, or that should have been known, at the time a decision was made. Utility investments are reviewed based on a "used and useful" standard to ensure utility assets are appropriately sized and used to provide adequate and reliable service to customers. *Id*. at 12-13.

Traditional regulation is not perfect. Commission Staff and other stakeholders such as consumer and environmental advocates participate in rate cases to provide a balance to the utility's one-sided evaluation of its own costs and revenues; however, information and resource asymmetry are significant issues. *Id*. at 14. The utility has unlimited access to information on its operations and investment plans and more resources than other stakeholders to use in litigation. *Id*.

Traditional regulation does provide incentive for utilities to make prudent investments and to control costs. Specifically, the justification for using a "test year" is to encourage utility management to control and reduce costs because by doing so, the utility can maximize its opportunity to earn at or above the authorized return level between rate cases. *Id*. at 15. This is because prices established in a rate case are fixed until the next rate case, causing any different (positive or negative) to be borne by utility shareholders in the interim. *Id*.

The key difference for the Commission's purposes here is that traditional regulation adjusts utility rates and revenues at the same time. ComEd's proposal

separates discretionary investment projects from its overall costs of service and rate of return. First, the primary incentive for utilities to control their costs comes from the existence of regulatory lag. In the time in between rate cases, any cost savings achieved accrue not to utility customers but to utility shareholders. Second, investors can increase earnings by growing rate base. Once the Commission approves an investment, the utility (and its shareholders) will receive a return on those investments.

Under this framework, there is tension that exists between customers who want the lowest delivery bills possible and shareholders who want the highest delivery bills possible so as to earn higher revenues. For example, the utility has little incentive to invest in any new technologies which could provide substantial benefits directly to customers by helping them conserve energy because these technologies could replace existing rate base and result in lower profits for the utility. This creates a "split incentive" problem: customers have an incentive to invest in technologies that reduce their overall energy costs and utilities have an incentive to invest in technologies that create higher overall energy costs.

B. STRUCTURING ALTERNATIVE REGULATION

ComEd proposes Rate ACEP as a "pilot" alternative regulation scheme. ComEd Ex. 1.0 Rev. at 1. ComEd Ex. 1.0 Rev. at 4-5; 220 ILCS 5/9-201. The problem is that ComEd's proposal is not alternative regulation – it is a piecemeal cost recovery mechanism with some collaborative aspects grafted onto a traditional regulatory framework. ComEd even admits the proposal is a step away from traditional

regulation, and that it would in fact be "fair to say" that the proposal here is a mix of alternative regulation and traditional regulation. Tr. at 423.

Properly structured alternative regulation could provide a utility with incentives to achieve savings while preserving the key characteristics of the traditional regulatory framework: rates are frequently reviewed in a comprehensive proceeding that matches expenses and revenues and which focuses on investments that are actually used and useful to customers. CUB Ex. 1.0 at 16-17. The key is that the alternative regulation framework has to create incentives for both customers and the utility to take action which lowers customer bills. CUB Ex. 1.0 at 19. As a result, **a**lternative regulation, sometimes referred to as "incentive regulation" or "performance-based regulation," is usually a regulatory attempt to create new incentives and/or remove certain disincentives. CUB Ex. 1.0 at 16.

Typically, the goal is to replace periodic rate cases with a different process of regulation and achieve lower long-term energy prices. CUB Ex. 1.0 at 17. Alternatives to increasingly frequent and expensive rate cases include the features identified by the Illinois General Assembly when it enacted Section 9-244: rate case moratoria, price cap regulation, earnings monitoring and sharing arrangements or combinations of these approaches. *Id.*, citing 220 ILCS 5/9-244(a). As AG witness Michael Brosch testified, a successfully implemented alternative regulation framework is one designed to induce higher utility productivity in the long term while eliminating or reducing the need for

rate cases *and* while ensuring that any benefits from the resulting improved efficiencies are shared equitably between shareholders and customers. AG Ex. 1.0 at 8.

That is not to say all alternative regulation proposals are created equal. Under traditional regulation, the utility has an incentive to prudently select technologies, and deploy these technologies effectively as well as maintain efficient operations. CUB Ex. 1.0 at 17. ComEd's Rate ACEP is an example of a utility requesting that customers finance large capital investment costs without ensuring customers will receive any corresponding operational savings. *Id.* Up-front pre-approval of the kind ComEd is seeking here creates a significant risk for customers that cost savings might fail to materialize or because projected benefits don't accrue because the only incentive present is to come in under budget. *Id.* As Mr. Brosch points out, what ComEd proposes here is not any performance based ratemaking because it does not even attempt to measure the Company's performance against any overall cost-efficiency or service quality metrics. AG Ex. 1.0 at 13. The Company has failed to offer any identifiable benefits, performance metrics, or other means to assure that its proposal will adjust rates based on the utility's performance. AARP Ex. 1.0 at 3. No specific performance metrics are associated with the proposed programs, or specific ways of evaluating if the technology deployed failed or was beneficial. Tr. at 391.

Past alternative regulation proposals have called for the same types of annual reconciliations ComEd is proposing here, which only enhance the resource and information asymmetry between utilities and Intervenors. ComEd's proposal relies on

regular rate cases in addition to Rate ACEP and increases, rather than alleviates, the burdens on Staff and Intervenors to make sure the to make sure that the utility is investing – and deploying – wisely. AG Ex. 1.0 at 13; CUB Ex. 1.0 at 18. If Rate ACEP is approved, the Commission should expect to be pulled into a much more active role in the planning, budgeting and managing of capital investments through various filing review procedures, reconciliations and other activities. AG Ex. 1.0 at 47. In essence, ComEd's proposal would do in five months what it now eleven: formal discovery with expert witnesses investigating the prudence of proposed investments. Tr. at 581-582, 586, 590.

Traditional cost of service regulation has evolved through a series of landmark court cases in the United States to provide a set of defined parameters that create procedural fairness. CUB Ex. 1.0 at 18. Alternative approaches have to be evaluated using a clear and consistent framework that allows for comparison of the characteristics of traditional regulation versus the proposed incentives, the administrative burden created by potential new mechanisms, and an explicit effort to minimize unintended consequences which might result from new incentive mechanisms. *Id.* From a customer's perspective, as long as reliability is adequate, the primary measure of the effectiveness of a regulatory mechanism is impact on the customer's bill. *Id.*

Any alternative regulation plan should have the same goals as traditional regulation:

> The General Assembly finds that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable,

> environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens. 220 ILCS 5/1-101.

The key characteristics of alternative regulation should be transparency and accountability:

- It should provide a clear standard for evaluating whether it is successful, such as an overall reduction in customer bills and improvements in customer service (reliability improvements, reduction of billing errors, and improved customer access to data). CUB Ex. 1.0 at 19.
- It should facilitate the sharing of information and reduce administrative costs, so that it is not more resource intensive than the existing regulatory process on ICC Staff and Intervenors. *Id.*
- It should promote a collaborative review of proposed utility investments, and provide an opportunity for ongoing evaluation of investment performance. *Id.*
- It should provide an incentive to for cost-efficient investments that provide the utility with incentive to maintain the proper level and timing of investment which results in safe and reliable service. *Id.*

In order make sure these goals can be achieved, an alternative regulation plan must include unambiguous incentives that tie utility earnings directly to the effectiveness of utility investments, actions, and behaviors in reducing, or managing, customer bills. CUB Ex. 1.0 at 20. To balance the needs of shareholders and customers,

an alternative regulation framework would need to clearly motivate regulated utilities to invest in technologies that produce real quantifiable savings for customers, most likely by aggressively supporting active energy efficiency and demand response programs. *Id.* The Illinois General Assembly has already recognized the importance of creating incentives to develop these types of programs when it created the Energy Efficiency Portfolio Standard ("EEPS"). 220 ILCS 5/8-103. The problem is that these types of legislative mandates and standards will produce just enough energy efficiency to meet the mandates. CUB Ex. 1.0 at 20. Since from a customer's perspective the ultimate measure of effective regulation is the effect on the customer's total bill, any true alternative regulation proposal must include incentives which provide rewards for the utility only if real quantifiable savings are produced for customers. As AARP witness Barbara Alexander concludes, the purpose of alternative regulation in Illinois law is not to submit reports, but to identify how benefits that would not otherwise occur will be measured, what results will be tracked and reported, and how the baseline performance against which performance under the alternative regulation plan will be measured. AARP Ex. 1.0 at 18.

C. CREATING PROPER INCENTIVES

ComEd states it is not opposed to alternative regulation that would be based on a measure of actual utility performance, such as customer quality, reliability, performance – Tr. at 421 – but the company didn't propose any such thing. Instead, its proposal is designed to test "one aspect" of alternative regulation. *Id.*

There is a tremendous amount of economic value based on the current prices that customers pay for generation and transmission service. These prices are based on customer load shape, which is a measure of how efficiently system capacity is used. As Mr. Thomas explains, by reducing usage during peak times, total costs can be decreased for customers. During the past year, just a 3% reduction in total usage during the last year would have result in energy savings of more than $112 million (associated capacity, ancillary service, and transmission costs savings increase this amount). These savings are based on prices during a relatively low-priced year, and would be greater as the price of energy rises. This means there is a tremendous amount of value available through aggressive demand side initiatives. Capturing this value would require utility shareholders to change their focus to efficiently delivering affordable, clean, safe, and reliable electricity to customers. This change in focus could be accompanied by new rewards realized by helping customers minimize their costs and unlocking the value in energy efficiency and demand response. The bottom line is that ComEd and its customers could share the savings resulting from energy efficiency and demand response initiatives, and alternative regulation could be used to develop such a sharing plan.

An appropriate alternative regulation plan could accomplish this balance by constructing a sharing mechanism that gives utilities an economic incentive to develop demand-side initiatives while simultaneously stabilizing and reducing or controlling costs for customers. ComEd Ex. 1.0 at 27. A sharing mechanism would be appropriate

for utility investments that replace traditional rate bases assets and provide benefits that accrue directly to customers. *Id.* For example, the availability of more granular meter data made possible by an investment in an AMI system could enable more efficient power procurement by the Illinois Power Agency ("IPA") which in turn would lower customer bills; however, today ComEd will not make such an investment absent some type of return for providing this data. *Id.* ComEd's proposal to investigate expanding AMI investment under Rate ACEP addresses only their incentive – any alternative regulation approved by the Commission has to include the customer side of the equation as well.

The Commission must still ensure that projects included in an alternative regulation plan are implemented prudently. Traditional prudency evaluations should be maintained for utility implementations, but they can be determined in a collaborative proceeding and the utility can remain responsible for implementation. CUB Ex. 1.0 at 29. Since pre-approval of investments is tremendously valuable, any pre-approval of utility investments should be accompanied by significant reductions in the cost of capital used to develop and set rates for these investments. *Id.* If the sharing mechanism and the associated metrics are developed appropriately, customers would be assured that the utility service they are paying for is provided at the lowest possible cost. *Id.* Utilities would have the incentive to operate their systems efficiently and provide tools and programs to customers that help to manage costs. This represents a

dramatic change from the system today, a system where customers see only cost increases from utility investments.

Under any alternative regulation plan, it would be crucial that the Commission is able to compare the utility's performance with respect to established metrics. CUB Ex. 1.0 at 28. While the specific level of performance the utility would be required to meet might depend on the type of project being proposed, there are general categories, many of which the Commission already reviews, which can serve as a starting point:

- Reducing Customer Bills: Reduction in customer delivery charges, supply charges, etc. CUB Ex. 1.0 at 30.
- Improving Customer Service: Improvements in call center performance regarding response times tied to caller satisfaction, reduction of billing errors, increased customer access to customer usage data, etc. *Id.*
- Improving Reliability:[1] Reduction in system-wide total number of minutes per year of sustained outage per customer served as reflected by the System Average Interruption Duration Index (SAIDI); reduction in any outage duration as reflected by the System Average Interruption Frequency Index (SAIFI); reduction in the number of momentary outages per customer system-wide per year as reflected by the Momentary

[1] Other examples can be found in: Reliability Metrics for the Perfect Power Seal of Approval, published by the Galvin Electricity Initiative., and The Draft Report on Consensus and Non-Consensus Smart Grid Metrics Submitted to the California Public Utility Commission by: Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, In consultation with: Environmental Defense Fund.

Average Interruption Frequency Index (MAIFI) and the number of customers per year and circuits per year experiencing greater than 12 sustained outages; improvements in system load factor and load factor by customer class; increase in the number of and total nameplate capacity of customer-owned or operated, utility grid-connected distributed generation facilities. *Id.*

- Improving Power Quality: Minimization of line losses and improvements in the distribution load factors. *Id.*
- Improvements in Utility Efficiency: Reduction in O&M expenses as a percentage of rate base,[2] the benchmarking of utility O&M expenses as compared to comparable utilities. *Id.*

The Commission could review the utility's performance as measured against these metrics, which could be developed generically or based on a specific utility project. *Id.* If the company has failed to meet the established metrics, no sharing would occur, and penalties could be imposed. *Id.* If the company has met the metrics, the revenues could be split based upon the established amount; if the company has exceeded the metrics, additional sharing could result. The key here is that any revenue sharing is based on customer total bill impacts because the entire goal of a change in the regulatory framework would be to make customers better off. *Id.* When this metric is

[2] For other examples see: Cost and Cost Transparency Metrics for the Perfect Power Seal of Approval produced by the Galvin Electricity Initiative (Attached as CUB Ex. 1.4).

satisfied, the utility would be able to increase earnings based on their effectiveness in reducing, or controlling, costs for customers. *Id.*

While Staff and all Intervenors agree that ComEd's proposal should be rejected, not all of the parties address what might be appropriate goals for an alternative regulation framework in Illinois. However, there is some common ground identified already. For example, NRDC Witness Dylan Sullivan and CUB witness Thomas both agree on the goals of a potential alternative regulation mechanism: "[t]he goals of the mechanism are to reduce the energy bill in ComEd's service territory, increase the efficiency with which ComEd's customers use energy, and lower pollution." NRDC Ex. 1.0 at 7. The ultimate measure of the effectiveness of regulation should be the effect on the customer's total bill, inclusive of the "energy bill" discussed by Mr. Sullivan. *Id.*

V. CONCLUSION

The Commission should reject ComEd's proposal to adopt Rate ACEP since it does not meet the legal standard for an alternative regulation plan under the PUA. The record shows that ComEd's proposal does not result in customer benefits or rates that are not likely to occur absent traditional regulation. Fundamentally, any alternative regulation framework must create incentives for the utility to reduce customer bills. To do this, the plan must include unambiguous incentives that tie utility earnings directly to the effectiveness of utility investments, actions, and behaviors in reducing, or managing, customer bills. If the Commission sees value in alternative regulation, the

Commission could open an investigation of alternative regulation mechanisms that might be appropriate for Illinois utilities. In any such proceeding, the Commission should be clear that the goals of any such mechanism are to better control total bills for customers.

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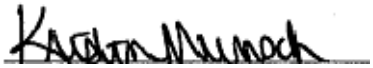
Respectfully submitted,



Kristin Munsch, Attorney
Christie Hicks, Attorney
CITIZENS UTILITY BOARD
309 W. Washington, Ste. 800
Chicago, IL 60606
(312) 263-4282
kmunsch@citizensutilityboard.org