ICC Docket No. 10-0467
CUB Ex. A

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	**)**	
	)	**Docket No. 10-0467**
	)	
Proposed general increase in electric rates	**)**	

DRAFT PROPOSED ORDER
OF THE CITIZENS UTILITY BOARD

Pursuant to the direction of the Administrative Law Judges and the Rules of Practice of the Illinois Commerce Commission, the Citizens Utility Board hereby submits the attached draft Proposed Order.

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ORDER

ISSUES

I. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY

ComEd's Proposed Tariffs reflect a revenue requirement of $2.337 billion, an increase of $396 million above current delivery service rates. ComEd based that request on a return on equity of 11.5%, an increase of 120 basis points over the Company's most recently approved return on equity. Over the course of the proceeding, ComEd lowered its request to a revenue requirement of $2.267 billion, an increase of $326.3 million, with a return on equity of 11.3%.

Staff and intervenors, including the People of the State of Illinois, represented by the Attorney General ("AG") and the Citizens Utility Board ("CUB") presented evidence demonstrating that ComEd's request is unjustified. The Commission's findings and conclusions are set forth below.

II. RATEMAKING AND THE NEED TO BALANCE SHAREHOLDER AND RATEPAYER INTERESTS

III. TEST YEAR

ComEd based its revenue requirement on an historical 2009 test year with pro forma adjustments. While parties took issue with the time frame for which pro forma adjustments should be allowed, no party contested the test year. The Commission approves the 2009 historical test year ComEd proposes for this proceeding.

IV. RATE BASE

A. Overview

B. Potentially Uncontested Issues

C. Potentially Contested Issues

1. Post-Test Year Adjustments

a. *Pro Forma* Capital Additions

CUB's Position

CUB avers that the Company's forecast of plant additions for the second quarter of 2011 should be eliminated, as those forecasts represent costs that cannot be characterized as "known and measurable" with any degree of certainty. AG/CUB Ex. 2.0 at 4-5. CUB agrees with the position of Staff witness Ebrey who explained that the Company's forecasts through June 2011 have changed significantly through the course of this case. Staff Ex. 16.0 at 10. ComEd argues that because it has provided voluminous documents to support its adjustments, it has satisfied the requirements of Section 287.40. ComEd Init. Br. at 9. However, Mr. Effron and Ms. Ebrey testify that those documents have done precisely the opposite — they have shown that the Company's budget has changed no fewer than three times just during the course of this proceeding. Staff Init. Br. at 5. CUB agrees with Ms. Ebrey that changes of this magnitude have previously resulted in disallowance by the Commission, and signify that the expenses for which the Company seeks recovery are not known and measurable at this time. Staff Ex. 16.0 at 10-11. Therefore, AG/CUB witness Mr. Effron proposes to eliminate all plant additions after March 31, 2011, which can be trued up to match actual expenditures through that date before the final order in this case. AG/CUB Ex. 2.0 at 5. As ComEd notes, CUB does not suggest that ComEd will not make expenditures between March 31 and June 30; however, the CUB notes that Company cannot recover forecasted costs unless they are known and measurable. Mr. Effron points out that following ComEd's last rate case, their actual expenditures on pro forma post-test year plant additions were $41 million less than the Company's forecast. AG/CUB Ex. 2.0 at 5. The Company reduced its 2010 forecasted plant additions by $52 million from direct to rebuttal testimony in this case. AG/CUB Ex. 8.0 at 3. Mr. Effron argued for limiting the plant adjustment to additions through March 31, 2011, approximately three months before the rates in this case go into effect, to allow the Company's forecasts to be trued up to actual additions to plant in service through that date. *Id.* at 5.

In support of that position, Mr. Effron notes that the Company's actual gross additions to jurisdictional plant in service in the first quarter of 2010 averaged about $41 million per month, while depreciation expense and growth in ADIT, combined, were approximately $39 million per month. AG/CUB Ex. 8.0 at 3. Mr. Effron avers that small shortfall in actual spending below forecasted spending--as little as 5%--would result in the plant additions being offset by depreciation expense and growth in ADIT. AG/CUB Ex. 8.0 at 3. Mr. Effron also found that such a shortfall seems likely in light of the Company's actual vs. forecasted spending in its last case, as well as its decreased forecast in this case. CUB argued that not only are these forecasts not known or measurable, but the plant additions are unlikely to result in an increase to rate base if actual numbers were relied on.

The Company attempted to calculate whether it has spend close to its projections in the past four years to demonstrate that it typically comes close to its forecasts. ComEd Init. Br. at 12. However, as CUB notes, in calculating the previous four years, the Company excluded eighteen entire months that it deemed "exogenous and unusual." *Id*. CUB states that ComEd's calculation that it has come within 2.6% of forecasted spend is based on cherry-picked information, chosen because it was beneficial to the Company's position.

To remove the Company's forecasts of plant additions for the second quarter of 2011, CUB argues that rate base should be reduced by $233,693,000 on capital additions to distribution plant ($164,041,000), general plant ($45,482,000) and intangible plant ($24,170,000). AG/CUB Ex. 7.1 Schedule B-1.

Commission Analysis and Conclusions

Staff, the People and CUB have all recommended disallowances of a portion of ComEd's requested pro forma plant additions. ComEd has failed to demonstrate that pro forma plant additions after March 31, 2011 are known and measurable. The significant changes to ComEd's budget testified to by Ms. Ebrey are a heavy factor in the Commission's decision. The Commission agrees with the recommendation of Mr. Effron that the Company should move a late-filed exhibit into the record with actual expenditures as of March 31, 3011, and only those actual expenditures shall be included in rate base.

b. Accumulated Provisions for Depreciation and Amortization Related Provisions for Accumulated Depreciation

CUB's Position

CUB argues that the Company has failed to match corresponding growth in accumulated depreciation on existing plant through the time for which they request pro forma plant additions. AG/CUB Ex. 2.0 at 11-12. CUB states that the Company has chosen to ignore the directive of the Illinois Appellate Court, in an appeal from ComEd's most recent rate case, to adjust the depreciation reserve to the same date as pro forma plant additions are included in rate base. *Commonwealth Edison Co. v. Ill. Commerce Comm'n* et al., 937 N.E.2d 685 (Ill. App. Ct. 2010). CUB notes the court's holding in that case, "The increase in accumulated depreciation on the existing plant during the post-test-year period, in which the additional plant is being factored into the rate base, is a change that affects ratepayers and therefore must be factored into the rate base." *Id.* at 704. The Company states that they have ignored this directive because they have appealed that ruling to the Illinois Supreme Court and therefore the issue has not yet been decided. ComEd Ex. 55.0 Rev. at 7. CUB indicates that there is no certainty that the Illinois Supreme Court will elect to hear ComEd's appeal, and even if it does, the decision of the Appellate Court is law until and unless the Illinois Supreme Court decides differently. CUB notes that the Company has failed to cite any precedent (absent a stay, which has not been granted in this case) for ignoring an Appellate Court decision simply because one or more parties have appealed that decision to the Supreme Court.

CUB points to the Appellate Court's recent decision, which found it necessary to acknowledge growth in accumulated depreciation correspondent with the date to which the Company has included post-test-year plan additions. Pro forma adjustments are allowed by the Public Utilities Act only if "all known and measurable changes" are taken into account. *Commonwealth Edison Co.*, 937 N.E.2d at 704, *citing* 83 Ill. Adm. Code §§ 287.20, 287.40.

CUB agrees that the Company has already accounted for post-test- year changes in depreciation reserve related to retirements, depreciation expense on post-test-year plant additions, salvage value, and cost of removal. AG/CUB Ex. 2.0 at 12. CUB finds that depreciation on embedded test year plant in service is a known and measurable change that must be taken into account. *Id.* CUB contends that the Company's approach of selectively choosing which factors it would prefer to have included in post-test year calculations is both poor policy and is inconsistent with the law.

Mr. Effron proposes to allow post-test-year plant additions through March 31, 2011. CUB would therefore calculate all depreciation, including depreciation on test year embedded plant, through that date. AG/CUB Ex. 2.0 at 10-13; AG/CUB Ex. 8.0 at 6-7. This adjustment increases the depreciation reserve by $490,108,000. AG/CUB Ex. 7.1, Schedule B-3.

Commission Analysis and Conclusions

The Commission agrees with the recommendations of Staff, IIEC, the People and CUB that accumulated depreciation on existing plant must be calculated as of the same date as *pro forma* plant additions. This is proper both under the matching principle and under the recent decision of the Illinois Appellate Court addressing this very issue. The Commission is bound by that decision, which was properly-decided. Because the Commission finds it appropriate to calculate pro forma plant additions through March 31, 2011, accumulated depreciation on existing plant should be calculated as of that date as well.

c. Accumulated Deferred Income Taxes (ADIT)

CUB's Position

CUB contends that the recent Appellate Court decision cited above dictates that the date from which the ADIT reserve is calculated must also match the date to which post-test-year additions are allowed. *See* Section IV C 1 b. The Company has recognized the incremental ADIT that would be generated by pro forma adjustment to post-test-year additions to plant in service, but has failed to recognize the growth in ADIT related to embedded plant as of the end of the test year. AG/CUB Ex. 2.0 at 13. CUB argues that by failing to properly calculate ADIT, the Company ignores the fact that the growth in ADIT related to plant in service as of December 31, 2009 is a source of funding for post-test-year plant additions. *Id.* CUB notes this decision is also contrary to Illinois law.

In accordance with his proposal to include adjustments through March 31, 2011, Mr. Effron proposes to increase ADIT by $39,209,000. AG/CUB Ex. 2.0 at 13-14; AG/CUB Ex. 8.0 at 7-8; AG/CUB Ex. 7.1, Schedule B-3.

Commission Analysis and Conclusions

The Commission agrees with Staff, IIEC, the People and CUB that ADIT should also be calculated as of the same date as pro forma plant additions. We find that ADIT should be adjusted as of March 31, 2011.

2. Construction Work in Progress ("CWIP")

CUB's Position

CUB notes that construction work in progress can be included in rate base under the Public Utilities Act, and ComEd has elected to include CWIP by capitalizing Allowance for Funds Used During Construction ("AFUDC") on CWIP with a total expected expenditure of greater than $25,000 and an expected construction period of greater than 30 days. AG/CUB Ex. 1.0 at 18. The Company also seeks recovery of "short-term CWIP," which is not eligible for AFUDC because it has a shorter construction period. *Id.* AG/CUB witness Mr. Brosch recommends disallowance of this short-term CWIP because, due to its short construction period, it is likely that ComEd did not actually pay for the construction until after it was already completed. *Id.* at 18-19. Additionally, CUB argues that the Company's use of a "proxy" for determining the amount of CWIP makes it impossible to determine whether the projects the Commission approves will ever be used and useful. Mr. Brosch noted that ComEd's study of cash flows has shown that payment to ComEd employees occurs an average of 14.64 days after labor costs were incurred, and miscellaneous cash voucher payments to vendors occur with average of 64.34 day delay. *Id.* at 19. CUB indicates that the result of this lag is that the vendor who performs the work finances the project during this delay of payment, and by the time payment is made, the work is complete. CUB notes that where the Company has little or no actual cash investment, no return from customers is appropriate. *Id.*

CUB avers that ComEd witness Ms. Houtsma mischaracterizes Mr. Brosch's disallowance by making it appear that his recommendation is contrary to the PUA. Mr. Brosch does not take issue with the Company's AFUDC, which accounts for construction work in progress, and he even recommends that the Company should include all CWIP in AFUDC rather than counting short-term CWIP separately. AG/CUB 7.0 at 27-28. Mr. Brosch suggests that all CWIP could and should be included in rate base in this manner. The Company chooses to count short-term CWIP separately from AFUDC. *Id.* at 28. CUB indicates that this is likely because if the short-term CWIP balances were reduced for vendor-provided working capital, there may be no significant remaining balances that would accrue any AFUDC at all. *Id.*

CUB also states that the Company mischaracterizes Mr. Brosch's argument regarding the "used and useful" standard as it relates to CWIP. ComEd Init. Br. at 26. The PUA allows for the inclusion of CWIP despite the fact that it is not used and useful, but the Company's failure to include specific projects in its CWIP calculation and to simply use the overall level of short-term CWIP as of year-end 2009 as a "proxy" does not provide the Commission with evidence that any projects for which it seeks recovery will ever be in service; that is the basis of Mr. Brosch's "used and useful" objection. AG Init. Br. at 15. The Company has stated that the amount of CWIP that it is requesting is the overall level of short-term CWIP at the end of 2009 (ComEd Ex. 6.0 Rev. at 26), but has also stated that the short-term CWIP for which they seek recovery will be providing service within weeks of the end of this case. ComEd Init Br. at 26, *citing* ComEd Ex. 55.0 2nd Rev. at 33. Obviously, according to CUB, the short-term CWIP amount requested based on December 2009 figures should have gone into service well before now. The Company has failed to demonstrate precisely for what they seek recovery, using proxies and vagaries instead.

Mr. Brosch calculates that removing short-term CWIP from rate base results in a disallowance of $12,591,000. AG/CUB Ex. 7.1, Schedule B-7.

Commission Analysis and Conclusions

We agree with Mr. Brosch that the Company's requested short-term CWIP is mostly, if not entirely, vendor-financed. Additionally, the Company's use of a "proxy" figure in their CWIP request makes a used and useful evaluation impossible. Therefore, we allow no short-term CWIP recovery.

3. Specific Plant Investments

<u>c. Underground Cable</u>

CUB's Position

CUB notes that the underground cable costs for incurred outside of the test year, in 2005-2006, and were previously disallowed in ComEd's last rate case, ICC Docket 07-0566. AG/CUB Ex. 2.0 at 9. The Company's explanation is that it disagreed with that disallowance at the time, though it didn't oppose it as part of a stipulation with Staff, and the Final Order in that case did not state explicitly that the costs would be excluded in the future as well if the Company re-introduced them. ComEd Ex. 29.0 at 11. ComEd argues that in its Brief on Exceptions in that case it stated that it was not precluded from seeking to include those costs in the future, and therefore it should be allowed to here. *Id.* However, CUB avers that the Commission chose not to make such a finding in the Final Order of the case, as evidenced by the fact that ComEd can only cite to its own brief on exceptions as authority for that premise.

CUB states that there is no precedent for reconsideration of costs incurred three to four years before the test year, which were previously presented in a rate case and disallowed, to be included in a later rate case. CUB contends that these costs were not disallowed simply because the Company entered into a stipulation with Staff. The Commission made specific findings and made a specific adjustment to the disallowance proposed by Staff based on evidence provided by ComEd. ICC Docket No. 07-0566 September 10, 2008 Final Order at 46. CUB also states that the stipulation is meaningless if the Company is allowed to request recovery in this rate case, and parties will be unlikely to engage in such negotiations in the future. CUB also notes that the Company may in the future request recovery for other disallowed costs if they think they can argue that there was not a specific finding in the previous case for one reason or another. CUB argues that the Commission should give no credence to the Company's repeated arguments as to the prudency of these costs, as this issue has already been litigated and there is no precedent for reconsideration. CUB calculates that ComEd's rate base should be reduced by $15,222,000 to remove these previously-disallowed costs. AG/CUB Ex. 7.1, Schedule B-2. Additionally, CUB requests that the Company be prohibited from attempting to re-litigate disallowances in the future, as it is unnecessarily burdensome on Staff and Intervenors, and it detracts from the relevant issues in the case.

Commission Analysis and Conclusions

The Commission disallowed these costs in the Company's last rate case. There is no precedent for re-litigating previously-disallowed costs, and we agree that allowing such would encourage utilities to litigate the same costs indefinitely. The Company reached settlement with Staff and agreed to remove these costs, and we continue to honor that settlement.

4. Cash Working Capital

CUB's Position

The Company initially requested $95.7 million of cash working capital, and revised that request in Surrebuttal to $67.7 million. ComEd Ex. 7.0 Rev. at 2, ComEd Ex. 57.0 at 2. CUB states that these requests are the result of a flawed Lead/Lag study, which if accurate, would mean that the timing of ComEd's cash flows have changed dramatically since its late rate case. AG/CUB Ex. 1.0 at 22-23. Mr. Brosch states that it is unlikely that such a change has occurred; rather, the incorrect calculation of the revenue lag in the Lead/Lag study has radically skewed the results. *Id.* The most significant flaw about which Mr. Brosch testified is the Company's choice to group revenue collections into several broad categories, using the mad-points of those categories as the assumed age of all receivables in that group. *Id.* Mr. Brosch states that this methodology does not precisely calculate when ComEd actually collects revenues, in part because the ages assigned to those categories are mid-points, not averages. *Id*. For example, with regard to customer bills, or receivables, the Company lumped together all receivables that were 31-60 days old and assigned them an age of 45 days old, without any analysis or supporting data. *Id.* at 27. CUB avers that it is possible that 90% of receivables 31-60 days old are actually 31-35 days old, causing a mid-point (rather than an average) to be inaccurate. *See Id.* at 28-29.

CUB also indicates that the results of ComEd's lead/lag study are skewed by the inclusion of receivables over 90 days old in the results, as the Company has recognized that older receivables are most likely uncollectible. *Id.* at 31. CUB avers that although the Company arbitrarily chose to designate only receivables greater than 365 days older as uncollectible, they have produced no evidence to show that receivables greater than 90 days old are also not largely uncollectible. *Id.* Mr. Brosch did his own calculation to demonstrate the arbitrariness of choosing 365 days as the uncollectible cut-off. AG/CUB Ex. 1.0 at 33. He found that if the receivables aging data in the 91-120 and 121-365 day intervals was excluded, using the other figures from the ComEd Lead/Lag study, would yield a negative $45 million CWC requirement. *Id.* CUB believes that it is entirely likely that many if not most receivables older than 90 days are uncollectible, and therefore that a negative CWC is appropriate. Mr. Brosch found that excluding even just the 121-356 day interval would result in a negative $21.2 million CWC. *Id.* at 34. However, CUB did not advocated for these positions because without calculations and analysis to back up the assumptions, they are just as arbitrary as what ComEd has done. *Id.* at 33. The Company complains that no party put forth an alternative Lead/Lag study for the Commission to consider; CUB notes that no party could perform an accurate analysis of receivables aging data because the Company cited information technology limitations as preventing them from providing more precise information. Tr. at 1080, 1085, 1086, 1088, 1092, 1102, 1106, 1107, 1120.

CUB notes that the Company recognized flaws in its Lead/Lag study, as it amended its calculations to include more granular data on Surrebuttal. ComEd Ex. 57.0 at 3-4. However, CUB argues that the Company continued to use inordinately large lump groups, and continued to use 365 days as the arbitrary cut-off for when a receivable becomes an uncollectible.

Mr. Brosch recommends the Commission adopt a zero allowance for CWC. AG/CUB Ex. 1.0 at 21-35; AG/CUB Ex. 7.0 at 11-25. He explained that a properly prepared Lead/Lag study that fully considers the timing of all cash expenses will often return a negative or nearly-zero CWC result because of the extended periods of time over which utilities often pay certain taxes and interest expenses. AG/CUB Ex. 1.0 at 22. CUB avers that such a proper study is not possible without more detailed information from ComEd, and that this study is fatally flawed and cannot be relied upon. Therefore, Mr. Brosch recommends a total disallowance of $89,703,000 to remove CWC. AG/CUB Ex. 7.1, Schedule B-5.

Commission Analysis and Conclusion

The Company requests a CWC allowance of 67.741 million, and states that no company challenged this calculation with a study of their own. However, by the Company's own admission, the information that other parties requested in order to perform such calculations was not available. The Company did not request any CWC in its last rate case, and the Commission finds it unlikely that they would not have requested CWC if they had calculated that such an allowance was necessary. More likely, the Company found that methodologies similar to those used by other utilities recently returned a more favorable CWC result, which is why ComEd now makes such a request. We agree with the People and CUB that no CWC allowance is appropriate.

5. 2009 Pension Trust Contribution

CUB's Position

AG/CUB witness Mr. Effron indicates that the Company made a "catch-up" contribution to its pension fund in 2009 to improve the underfunded status of the plan. AG/CUB Ex. 2.0 at 15. Mr. Effron notes that for the three years prior to 2009, 2006-2008, the Company made inadequate contributions to its pension plan, accruing $106 million during those years while the contributions were only $15 million. *Id.*, AG/CUB Ex. 8.0 at 8. CUB argues that if the Company had made adequate contributions to its pension plan from 2006-2008, then the unusually large contribution in the test year would not have been necessary, even in light of the economic downturn. AG/CUB Ex. 8.0 at 9. ComEd argues that the effect on ComEd's rate base would have been roughly the same whether the necessary contributions were made over several years or all in 2009. However, Mr. Effron testifies that if the contributions in 2006-2008 would have been equal to the accruals in those years, there would be no prepaid pensions that should be included in rate base. AG/CUB Ex. 2.0 at 15.

CUB disagreed with the Company's argument that the entire amount of its contribution should be allowed simply because making the contribution "was the right thing to do." ComEd Ex. 4.0 at 23. CUB states that it was also the right thing to do in 2006, 2007 and 2008—yet the Company chose to underfund the plan in each of those years and instead do a catch-up contribution in the test year, 2009. CUB avers that at the point where the Company chose to underfund the plan three years in a row, it then becomes shareholders' responsibility, because shareholders benefitted from bigger returns in each of those years where an inadequate contribution was made.

CUB's adjustment reduces ComEd's rate base by $68,750,000, which is the difference between the $92,591,000 in deferred debits ComEd has included in rate base minus the offsetting adjustment to remove ADIT of $23,841,000. AG/CUB 8.0 at 9-10, AG/CUB Ex. 7.1, Schedule B-4 and Schedule DJE 1.5.

Commission Analysis and Conclusion

We decline to approve ComEd's request to include $92.5 million of pension contribution in rate base. Instead, we agree with AG/CUB witness Mr. Effron, that the primary cause of the underfunded status of the pension fund was actually underfunding from 2006-2008. The Company's claims that it should be allowed to fully-recover this contribution because it "was the right thing to do" and their testimony from a union worker about unions' reliance on the Company pension is not relevant to the specific finding that we must make, whether the amount was reasonable. And we find that it is not.

7. Customer Deposits

CUB's Position

CUB contends that customer deposits are a low cost source of capital for the Company. AG/CUB Ex. 1.0 at 36. Because they represent ratepayer-provided capital that is continuously available to the utility, customer deposits are typically subtracted from rate base with corresponding interest paid recovered from customers. *Id.* at 36-37. CUB notes that it is in the Company's interest to recognize the smallest amount of customer deposits as possible since they are subtracted from rate base. Mr. Brosch testified that ComEd made several errors in calculating customer deposits which resulted in underestimation and increased rate base.

Mr. Brosch found that the balances of customer deposits have been consistently growing since 2006 and throughout 2009. AG/CUB Ex. 1.0 at 37. Therefore, Mr. Brosch concluded that using a 2009 average serves only to underestimate the amount of customer deposits. Mr. Brosch believes that the "seasonality" ComEd uses to justify using this average (ComEd Ex. 29.0 at 37) does not explain this consistent, year-over-year growth. AG/CUB Ex. 7.0 at 31. CUB disagrees with ComEd's assertion that this trend will not continue. ComEd Init Br. at 50. CUB argues that while the Company is correct that the majority of growth happened in 2009, growth was consistent in years prior as well. AG/CUB Ex. 1.0 at 37. The Company did not contest this fact.

The second issue raised by CUB is the Company's claims that only a portion of its total collected customer deposits are jurisdictional. ComEd Ex. 29.0 at 37. CUB avers that all of the customer deposits that have been collected by ComEd have been collected in Illinois, and none have been used to reduce FERC rate base. *Id.* at 37-38. The Company's comparison of customer deposits to jurisdictional plant (ComEd Ex. 29.0 at 38) is a straw man argument, according to CUB. There are only two jurisdictions between which a cost can be split-- non-jurisdictional plant is used for transmission rather than delivery, and is claimed in FERC rate base rather than Illinois jurisdictional rate base. CUB maintains that customer deposits neither relate to transmission nor are used to reduce FERC rate base. Both in testimony and when asked in a data request from CUB, ComEd has failed to identify to what other jurisdiction customer deposits are attributable. AG/CUB Ex. 7.0 at 29-30. The Company claims that not every item is necessarily either included in FERC or Illinois rate base, but CUB contends that the Company points only to revenues, no expense items, for which this is true. CUB Reply Br. at 9. CUB states that ComEd's choice to claim some part of its customer deposits balance as "non-jurisdictional" does nothing more than increase rate base and allow ComEd to retain the benefit of this low-cost source of funding supplied by ratepayers. *Id.* One hundred percent of customer deposits balances should be attributed to retail delivery services and calculated as a reduction to rate base based on Mr. Brosch's analysis. AG/CUB 1.0 at 38. CUB agrees with ComEd's choice to include interest in this calculation. *Id*. at 31.

To recognize one hundred percent of customer deposits, and to calculate the effect of customer deposits fairly using the 2009-year end balances, CUB recommends that ComEd's rate base should be reduced by $130,510,000. AG/CUB Ex. 7.1, Schedule B-8.

Commission Analysis and Conclusion

The Commission declines to use the average of 2009 customer deposit balances as ComEd has requested. As noted by Staff witness Tolsdorf and AG/CUB witness Brosch, the consistently-increasing nature of customer deposits is such that a year-end balance is more appropriate. ComEd has provided no evidence that its business has changed in such a way that customer balances are likely to stop increasing. Additionally, we find it consistent with the principle of fairness to both the Company and its customers that the Company must claim all revenues in some jurisdiction, and since customer deposits are governed by delivery service tariffs and are collected from ComEd's delivery services customers, 100% of customer deposits must be included here. We therefore agree with the recommendations of AG/CUB witness Mr. Brosch and Staff witness Mr. Tolsdorf.

D. RATE BASE (TOTAL)

Commission Analysis and Conclusions

AG/CUB provided substantial evidence that the Commission should adopt the recommendations of witnesses Brosch, Effron, and Smith, and set the Company's rate base at a value of $6,522,071,000. AG/CUB Ex. 7.1, Schedule A.

VI. OPERATING EXPENSES

B. Potentially Uncontested Issues

1. 2009 Amortization of Existing Regulatory Assets

ComEd accepted Staff witness Hathhorn's recommendation to amortize six regulatory assets. ComEd Ex. 30.0 at 7. The Commission approves Staff's proposal.

4. Investment Tax Credit Amortization (AG)

The Company agreed to Mr. Effron's proposal to amortize proceeds from the sale of investment tax credits. AG/CUB Ex. 2.0 at 28. This amortization reduces pro forma jurisdictional income tax expense by $113,000. AG/CUB Ex. 7.1 Schedule C-9. The Commission agrees with and approves.

C. Potentially Contested Issues

1. Incentive Compensation Cost and Expenses

CUB's position

CUB contends that there are three elements to ComEd's incentive compensation request: Annual Incentive Program ("AIP") expense, the executive Long-Term Incentive Plan ("LTIP") expense, and the Exelon 2009 Key Manager Restricted Stock Award. Mr. Smith recommended at least partial disallowance for each of these expenses. It is well-established by the Commission that the Company can recover those incentive compensation costs that are reasonable, related to utility services, and of benefit to ratepayers or utility service. ICC Docket No. 07-0566 Final Order at 61. CUB states that, according to Illinois law, only when a tangible benefit to ratepayers can be shown, or specific dollar savings calculated, should incentive compensation be recovered from ratepayers. ICC Docket No. 04-0779, Final Order at 44, ICC Docket No. 01-0432 Final Order at 42-43. CUB avers that the Company has failed to identify tangible benefits to ratepayers in its incentive compensation plans, and each should be adjusted accordingly.

The Company claims that its incentive compensation "is not extra compensation." ComEd Ex. 28.0 at 2. According to CUB, that is simply not true—incentive compensation is not part of employees' regular salary, and receipt of incentive compensation is not a given: employees have an opportunity to earn it, but in actuality they might not. ComEd claims that because other utilities also offer incentive compensation (*Id.*), they cannot be competitive unless they do too. CUB argues the two ways in which that argument is flawed. First, even though employees have the opportunity to earn incentive compensation, it is not a given that they will. Second, disallowance of all or part of ComEd's incentive compensation does not make ComEd less competitive with other utilities for human resources—the Company is free to continue offering the programs in the exact same manner, using shareholder funds. CUB notes the Company fails to address the impact of the current unemployment rate on its ability to attract and retain employees. According to CUB, the levels of incentive compensation that were once the norm are no longer necessary to attract and retain quality employees.

CUB demonstrates that the AIP should be limited to 50%, the amount of the actual payout under the plan in 2010. The cost of the Executive LTIP should be borne solely by shareholders, according to CUB, as it is driven by financial and legislative objectives and is closely related to the interests of Exelon's shareholders. CUB also argues that the Restricted Stock incentive program should also be borne by shareholders, as it is incurred to improve ComEd and Exelon performance for the benefit of shareholders, not to improve customer service or meet other regulated utility's service requirements.

a. Annual Incentive Plan ("AIP")

CUB explains that ComEd's AIP is calculated for employees based on various factors, including: 1) the employee's salary, 2) a Company Performance Multiplier ("CPM"), and 3) an Individual Performance Multiplier ("IPM"). AG/CUB Ex. 3.0 at 11. The factors considered in the CPM are achievement of Key Performance Indicators ("KPIs") and financial performance under the Net Income Limiter. *Id.* The KPIs associated with the AIP are ComEd O&M, ComEd capital expenditures, SAIFI (frequency of customer outages), CAIDI (duration of customer outages), OSHA (employee safety), Focused Initiatives and Environmental Index (productivity and environmental commitment), and customer satisfaction. *Id.* at 12-13. The purpose of the Net Income Limiter is the limit the payout on the AIP based on ComEd's financial performance. *Id.* at 13.

Mr. Smith notes that in its materials regarding AIP, ComEd has made it clear to employees and shareholders that the AIP is subject to reduction. *Id.* at 14-15. In December 2009, Exelon announced significant changes that will affect the AIP, effectively cutting AIP payouts in half for 2010. *Id.* This is in association with the Net Income Limiter of the plan. *Id.* However, the Company has failed to account for this 50% reduction in this case, which CUB states has resulted in an over-calculated the amount of recovery it should receive for AIP. *Id.* at 16. CUB indicates that it is simply appropriate for shareholders to bear some or all of the incentive plan costs—the CPM involves metrics that benefit both shareholders and ratepayers. In both of ComEd's most recent rate cases, says CUB, the Commission required ComEd shareholders to bear some of the cost of incentive compensation programs. CUB claims, as a result, the Company redesigned its AIP in an attempt to circumvent the sharing of such costs between ratepayers and shareholders. AG/CUB Ex. 9.0 at 7. The Company is open about the fact that it redesigned its program to eliminate the metric that was the basis of the Commission's disallowance in 07-0566. ComEd Ex. 28.0 at 4. ComEd claims "regulatory certainty is essential to enable utilities to manage their businesses...", but CUB concludes that its choice to change its programs to get as much recovery as possible from ratepayers does not provide regulatory certainty, it only shifts responsibility from the Company and its shareholders onto ratepayers. AG/CUB Ex. 9.0 at 7.

According to CUB, the Company has failed to show that 100% of its costs under the AIP provide tangible benefits to ratepayers, and the Company does not plan to pay on 100% of its plan in 2010. There is no certainty that it will pay to that level again in coming years. Therefore, Mr. Smith's recommends to reducing AIP by 50%. This results in an adjustment of $12.060 million. AG/CUB Ex. 9.0 at 9, AG/CUB Ex. 7.1 Schedule C-10.

b. Long-Term Incentive Plan ("LTIP")

CUB states that the Company's executive LTIP pays out to executives who meet certain operational and cost controls over time. AG/CUB Ex. 3.0 at 17. It is limited to officers and executives of ComEd. *Id.* Similar to its changes to the AIP, ComEd made changes to the executive LTIP in an attempt to gain the Commission's approval to include those costs in rates. *Id.* at 18. However, CUB maintains that the performance goals under the plan continue to driven by financial and legislative goals that benefit shareholders. *Id.* at 18-19. For example, Exelon's 10-K, in its description of the executive LTIP specifically names avoidance of adverse legislation as one of the metrics considered. *Id.* at 19. CUB notes that the Company is well aware that lobbying is typically disallowed for ratemaking purposes. *Id.* at 20. The 10-K also names financial goals, such as a certain return on equity. *Id.* at 20.

CUB argues that the expense of executive LTIP should be borne by shareholders. The Company has requested inclusion of 100% of executive LTIP in rates, which CUB states it has failed to demonstrate tangible benefits to ratepayers for any part of LTIP. CUB avers that the Company's position that "programs like" executive LTIP incent managers to make long-term business decisions that will benefit the business over the long term (ComEd Ex. 28.0 at 8) is not a tangible benefit to ratepayers. CUB demonstrates that this cost should be disallowed, resulting in an adjustment by $2.158 million. AG/CUB Ex. 9.0 at 9-11, AG/CUB Ex. 7.1 Schedule C-10

c. Key Manager Restricted Stock Plan

ComEd's Key Manager Restricted Stock program is limited primarily to directors and managers, who are awarded shares of Exelon stock. AG/CUB Ex. 3.0 at 23. CUB avers that stock-based compensation expense should not be charged to ratepayers. *Id.* at 25. The program is designed to improve ComEd and Exelon performance for the benefit of shareholders, and provides no tangible benefit to ratepayers. AG/CUB Ex. 9.0 at 11. The objectives of maximizing shareholder value are generally opposed to the objectives of minimizing costs to ratepayers. AG/CUB Ex. 2.0 at 25. Additionally, points out CUB, ComEd has admitted that key managers will see an approximate 33% reduction in the 2010 grant value of restricted stock, which it does not appear that ComEd has accounted for in its request. AG/CUB Ex. 9.0 at 11.

CUB argues that a program so obviously tied solely to shareholder interests must be disallowed. This results in a reduction of $2.123 million. AG/CUB Ex. 9.0 at 11-12, AG/CUB Ex. 7.1 Schedule C-10.

Commission Analysis and Conclusions

We decline to allow any LTIP or Key Manager Restricted Stock award costs, which are much more closely aligned with shareholder interests than those of ratepayers. Additionally, we allow only 50% of ComEd's requested AIP, reflecting the true payout in 2010. The Company has provided no evidence that their financial condition will change in future years such that AIP levels will again equal those of 2009, and the Company's choice to change the metrics used to calculate AIP does not, in itself, result in automatic full recovery.

2. Rate Case Expenses

a. Rate Case Expenses of the Instant Case

CUB's Position

CUB points out that the PUA allows attorney and expert witness fees incurred to prepare and litigate a general rate case filing to be recovered by a utility and the Commission must "specifically assess the justness and reasonableness" of these amounts, and the issue must be "expressly addressed in the Commission's final order." 220 ILCS 5/9-229.

The Company has requested recovery of $8.5 million in rate case expenses for the current case. AG/CUB Ex. 9.0 at 18. CUB avers that the Company has failed to meet the requirements of the PUA to show that these costs are just and reasonable. According to CUB, ComEd has not provided information with the level of specificity required to make such a determination, including failing to turn over the hours charged in order to determine the reasonableness of attorneys' fees, and has failed to justify paying exorbitant rates, up to almost $1,000 per hour, to some consultants. AG/CUB Ex. 9.0 at 20, 22. CUB also notes that the Company has included in its calculations costs incurred as a result of its alternative regulation litigation, Docket 10-0527, although the PUA allows recovery only for costs related to litigating a general rate case (See discussion below). ComEd has also presented multiple witnesses on the same topic, such as presenting four primary witnesses and three others who all comment on cost of capital. AG/CUB Ex. 9.0 at 24.

CUB notes that the Company has even included expenses for consultants who provide no testimony of rate analysis, and bill $225 to $980 per hour, and with no more detail than "services rendered in the month of April" to justify some amounts. *Id.* at 22. Given the poor economy and the high unemployment rate, CUB believes that one would expect the Company to show a higher degree of sensitivity to holding down rate case costs. CUB maintains that $980 an hour to a consultant who presents no testimony, with no description of services, is outlandish to ask ratepayers to pay—no matter how many hours were billed at that amount. CUB avers that while the Company is free to present its case as it chooses, it cannot recover the excessive cost of unreasonable and unjustified witnesses from ratepayers. *Id.* at 26. ComEd argues that it turned over "on-going status updates regarding its rate case expenses with invoices and descriptions" (ComEd Init. Br. at 59), but CUB points out that the Company does not acknowledge Mr. Smith's point that "descriptions" of only a few words are not enough to justify hundreds of thousands of dollars on a single line-item. AG/CUB Ex. 9.0 at 30. CUB states that requests such as $890,000 for "Post Direct Testimony Witnesses," which are not itemized by the Company, should be reduced to a reasonable level.

Mr. Smith notes that it is likely that the Company will not even spend up to its estimate of $8.5 million based on the costs it has incurred to date; as of October 31, deep into the case since much of the attorney and consultants' work comes before the case is even filed, ComEd had only incurred $4.274 million of expense, about one-half of the claimed total estimate. *Id.* at 20. The Company claims that its current spending is on pace with its last rate case (ComEd Init. Br. at 63), but CUB states that the Company does not take into account that in this case several consultants provided background "support" rather than testimony. Therefore, in this case, CUB believes that costs are likely more front-loaded than they were in the previous case, and ComEd is therefore not on track to spend all of the $8.5 million for which it seeks recovery. AG/CUB Ex. 9.0 at 26.

CUB argues that the Company's argument regarding its rate case expense, that the amount spent was less than it spent in its last rate case therefore it must be reasonable (ComEd Init. Br. at 59), fails to recognize that the Commission must make a specific finding as to the justness and reasonableness of this expense in its final order. 220 ILCS 5/9-229. According to CUB, the amount that the Company spent on its last rate case could be something the Commission might consider, but it is far from the only relevant factor. If the Commission accepts ComEd's argument in this regard, CUB suggests that the Company will have no incentive to spend below this level again, even if they could do so easily.

Mr. Smith's specific recommendations shown below:

Summary of AG/CUB Adjustments to ComEd's Rate Case Expense

Description		**Amount**
Economic Development/Jobs	$	(225,000)
Cost of Capital	$	(260,000)
Sullivan and Co., rate case support	$	(150,000)
Alternative Regulation witnesses and consultants	$	(250,000)
Over-estimate – Direct	$	(555,340)
Budget Overrun for CWC consultant	$	(100,000)
Adjustment to Post Direct witnesses	$	(661,000)
Attorneys Fees (per Staff)	$	(2,500,000)
Total AG/CUB adjustments	**$**	**(4,701,340)**
Company request	$	8,500,000
AG/CUB Proposed Total Allowance	**$**	**3,798,660**
Normalization Period, in Years		3
AG/CUB Proposed Annual Allowance ($1,000s)	**$**	**1,266,000**
ComEd Requested Annual Amortization Expense	$	2,833,000
AG/CUB Adjustment to ComEd's Annual Amount	**$**	**(1,567,000)**

Mr. Smith proposes that rate case expenses should be normalized over three years rather than amortized, as the Company as proposed. AG/CUB Ex. 3.0 at 46-47. He notes that ratepayers are at risk for over-paying for a utility's rate case expense if too short of a period for amortization is used. *Id.* at 46. For example, ComEd's amortization of its 2005 rate case was due to expire on December 31, 2009, but because new rates have not yet gone into effect, the Company has continued to recover on that expense which has already been fully reimbursed. *Id.* Mr. Smith testifies that the same risk is present here—if a three-year amortization is used, and rates are in effect for longer than three years, ComEd will recover more than it has actually expended on this rate case. *Id.* Mr. Smith explains that moving to a normalization approach for rate case expense, such as that which is used for O&M expense, helps to mitigate that risk. *Id.* at 47-48.

Normalized over a three-year period, Mr. Smith's adjustments to reduce or remove ComEd's unreasonable and unjustified rate case expenses result in a $1,567,000 reduction. AG/CUB Ex. 7.1 Schedule C-12.

Commission Analysis and Conclusion

We adopt the recommendations of Mr. Smith, detailed in the chart above. As the People and CUB noted, the Commission is charged with making specific findings as to the justness and reasonableness of rate case expenses, and the Company's failure to provide detailed descriptions of its expenses does not allow for such findings. Additionally, we agree that normalizing rate case expenses is appropriate in order to help ensure that the Company does not over-recover for these expenses.

b. Alternative Regulation Case

CUB's Position

ComEd has included alternative regulation litigation expenses in their request for recovery, though the PUA allows recovery only for fees incurred as part of a "general rate case filing." (AG/CUB Ex. 9.0 at 27-28, 220 ILCS 5/9-229), and CUB explains that the Company has refused to specify exactly what amounts for which it seeks recovery are actually related to the alternative regulation litigation for every attorney and witness involved in both cases. ComEd Ex. 30.0 at 14. The Company claims that it negotiated a flat rate with the R3 law firm, who gets the lion's share of the $8.5 million ComEd seeks to recover, for both the rate case and alternative regulation dockets. *Id.* CUB believes this was ComEd's own mistake. The PUA is clear that only expenses related to a rate case filing are recoverable. CUB contends that, at the very least, the Company should have turned over the hours each attorney and witness has worked on each case so that a specific percentage of their time could be clearly allocated to each case. CUB states that the Company has taken the unbelievable position that R3 law firm charged nothing extra to take on the alternative regulation docket. *Id.* CUB argues that the Company knows that is simply not true, and their attempt to collect legal fees from alternative regulation through this case by making such a claim is incredible. Mr. Smith's adjustments for this item, a $250,000 disallowance for alternative regulation witnesses and consultants and a $2.5 million disallowance for alternative regulation attorneys fees, are included in his overall rate case expense adjustment listed in subsection (a) above.

Commission Analysis and Conclusions

We decline to accept ComEd's argument that a law firm has agreed to provide representation for a second, labor- and time-intensive case, for free simply because it is also representing the Company in this case. Rather, the firm provided a bundled price, but that price would likely have been significantly lower were it not for the alternative regulation case. Because the Company has failed to provide hourly billing detail to demonstrate the allocation of resources between the two cases, it is reasonable to assume that half of the attorneys' fees are attributable to the second case. Only rate case expenses are recoverable, and so witness, consultant and attorneys fees related to the alternative regulation case are disallowed. We accept the recommendations of AG/CUB witness Smith in this regard.

3. Administrative and General (A&G) Expenses

a. Exelon Way Severance Amortization

CUB's Position

The Company has proposed to include severance expenses resulting from its restructuring program, "The Exelon Way," that it incurred in 2003 and 2004. AG/CUB Ex. 2.0 at 22. The restructuring program was designed to achieve savings of $70 million annually, and the Company incurred $158 of costs to achieve those savings. *Id.* However, AG/CUB Mr. Effron notes that the Company chose not to begin amortizing those costs until 2007, rather than when they were incurred and when the savings from the program were realized, three to four years earlier. *Id.* According to Mr. Effron, the benefits of the restructuring were retained solely by shareholders from 2003 through 2006. *Id.* at 23. In 2007, the Company chose to begin a 7.5 year amortization period for those expenses, approximately $21 million of which is included in the 2009 test year operation and maintenance expenses. *Id.* at 22. The Company began seeing savings from the restructuring program in 2003, immediately after it was implemented, says Mr. Effron. AG/CUB Ex. 8.0 at 16.

ComEd argues that Mr. Effron's recommendation would disallow recovery of 40% of the costs incurred by the Company. ComEd Init. Br. at 65. This is simply not true, as the Company already recovered, by way of savings, that entire amount. *Id*. at 15-16. Therefore, CUB believes that the Commission should calculate the amortization of these expenses as if it has begun in 2003, when those savings were first retained by the Company and its shareholders, which using a the Company's preferred 7.5 year amortization would mean that the expenses would now be fully recovered. *Id.* at 15-16. By the time the rates in this case go into effect, Mr. Effron testifies that the Company will have collected on this amortization for almost five and a half years, and received savings from the program for an additional four years prior. CUB demonstrates that the Company has fully recovered this expense, and it should now be removed. This results in an adjustment of $18,665,000. AG/CUB Ex. 7.1 Schedule C-4.

Commission Analysis and Conclusions

We agree with AG/CUB witness Mr. Effron that the savings the Company saw for several years before it began amortization of this expense, and the fact that the Company's 7.5 year amortization period would have run by now had that period begun when the expense was incurred, require that these costs now be disallowed. We agree that the Company has recovered the expense, and continuing to collect so far beyond the time at which it was incurred is inappropriate.

c. Pension Costs

CUB's Position

Mr. Smith indicates that the 2009 test year recorded amount of pension expense, which is based on a 2010 actuarial report rather than the 2009 test year expense, was abnormally high in comparison with recent years. AG/CUB Ex. 3.0 at 25, AG/CUB Ex. 9.0 at 17. Mr. Smith showed that the Company's request for $51.427 million exceeds the amount in each prior year since at least 2004. AG/CUB Ex. 9.0 at 17. The Company has claimed that this is primarily a result of investment losses experienced in 2008 as a result of the market recession. AG/CUB Ex. 3.0 at 31. CUB maintains that using this abnormally high amount is in appropriate.

The Company claims that use of the 2010 actuarial report is appropriate here because actuarial reports have been used in other cases in the past. ComEd Ex. 29.0 at 32-33. However, Mr. Smith testifies that the pension expense in those cases was significantly lower, by as much as 259%, than what has been requested here. AG/CUB Ex. 9.0 at 14. Use of the actuarial reports in those cases cannot then be compared to this case, where the markets have significantly changed the Company's pension expense. Additionally, Mr. Smith found that the report relied on by the Company was issued in March of 2010, and just since this case was filed, the Company's 2010 estimate, on which it based its request, had decreased. *Id.*

Mr. Smith contends that the 2010 actuarial study, which exceeds the test year recorded amount by 27.6 percent, should not be the basis for the pension expense allowance. *Id.* at 30. Instead, Mr. Smith recommends that the amount should be reduced by $14.209 million, the amount actually expended in the test year. *Id.* at 30, AG/CUB Ex. 7.1 Schedule C-11.

Moreover, Mr. Smith recommends that the cost of the Supplemental Executive Retirement Plan ("SERP") should be disallowed, since provision of additional compensation to Exelon's highest paid employees in retirement benefits relative to the Company's other employees is not a reasonable expense that should be recovered in rates. AG/CUB Ex. 3.0 at 33-35. Mr. Smith explains that SERPs provide retirement benefits to executives in excess of the limits placed by the IRS regulations on pension plan calculations. *Id.* at 34. Therefore, concludes Mr. Smith, the Company's executives would still receive the exact same retirement benefits available to any other employee without the SERP, and those benefits would even be proportional to their significantly higher salary. *Id.* CUB avers that ratepayers should not be charged for this extra benefit that is available only to a select group of highly compensated individuals, particularly during a period of deep economic recession and high unemployment. AG/CUB Ex. 9.0 at 18. ComEd is free to continue providing this benefit to its executives, but not at a cost to ratepayers. CUB argues that 2009 SERP, as well as settlement costs for retired executives under the SERP, should be disallowed.

The above discussions result a total reduction of $39,478,000 to (1) correct for the company's increase from 2009 to 2010 pension expense ($14,209,000), (2) remove 2009 Supplemental Executive Retirement Plan [SERP] and SERP settlements expense ($2,424,000) and (3) to normalize abnormally high 2009 defined benefit pension expense based on prior year average ($22,845,000). AG/CUB Ex. 7.1, Schedule C-11.

Commission Analysis and Conclusions

We agree with AG/CUB witness Mr. Smith that it is incorrect to base this allowance on the 2010 actuarial report. The calculations from that report are 27.6% higher than those of the test year, and have changed since the start of this case. It is more appropriate to use the Company's 2009 figures. Additionally, we decline to allow any portion of the Company's SERP and SERP settlements expense, which is unreasonable to recover from ratepayers. Finally, we accept Mr. Smith's recommendation to normalize the abnormally high 2009 defined benefit pension expense.

d. Wages and Salaries *Pro forma* Adjustment

CUB's Position

Mr. Effron notes that the number of ComEd employees has steadily declined from early 2009 through August 2010, including a sharp drop from June to July of 2009 related to the 2009 severance program. AG/CUB 2.0 at 18-19. Mr. Effron points out that the pro forma adjustment recognized by the Company was of only 108 employees; however, the actual number of employees had decreased by 300 from January 2009 through August 2010. *Id.* at 19. The Company stated that it did not recognize this full decrease because overtime offset the difference. *Id.*, ComEd Ex. 30.0 at 5. However, Mr. Effron determined that the decrease in payroll for those employees significantly exceeded the increase in overtime. AG/CUB Ex. 2.0 at 19-20, AG/CUB 9.0 at 11-12. Based on the Company's requested pro forma adjustment, Mr. Effron calculates that payroll expense in 2010 should actually be about $5.1 million higher than in 2009. AG/CUB Ex. 9.0 at 12. However, the Company anticipates that payroll costs will actually be $286,829 lower than 2009. *Id.* Mr. Effron's calculations demonstrate that ComEd's calculations are flawed.

Mr. Effron recommends an adjustment to reflect the decrease in employees through August 2010, net of the effect of overtime. AG/CUB Ex. 2.0 18-20; AG/CUB Ex. 8.0 at 11-13. This adjustment results in a reduction of $4,152,000 to pro forma test year expenses. AG/CUB Ex. 9.0 at 12, AG/CUB Ex. 7.1, Schedule C-3.

Commission Analysis and Conclusions

The Company's request fails to recognize the full amount of the decrease in wages during the test year and pro forma period, instead arguing that overtime offsets the amount. Mr. Effron testified that even accounting for overtime, the reduction of employees resulted in an over four million dollar deduction. We agree that Mr. Effron's calculation, which fairly accounted for the entire difference in the number of employees offset by resulting overtime, is correct.

f. Corporate Aircraft Costs (Uncontested b/t Company and Staff)

ComEd initially requested $918,000 for the fractional ownership interest in three corporate jets. AG/CUB Ex. 1.0 at 48. The Company claimed that use of corporate aircraft rather than commercial carriers was more efficient, but was unable to produce any plausible calculations or analyses to support that notion. *Id.* at 48-49. Mr. Brosch recommended that ComEd be allowed to recovery only half of the costs allocated to corporate aircraft, based on his calculation of what last-minute first-class flights would cost. *Id.* at 49. ComEd has adopted the recommendation of Mr. Brosch. ComEd Ex. 29.0 at 2. We accept Mr. Brosch's recommendation.

g. Perquisites and Awards

CUB's Position

Mr. Smith recommends disallowance of perquisites and awards above what is actually necessary attract and retain qualified personnel. CUB explains that two costs are at issue here, retention awards and performance-based awards. ComEd argues the entire amount of its $3.495 million in perquisites and awards benefit ratepayers and are reasonable business expenses. ComEd Init. Br. at 72. Additionally, Mr. Smith states that ComEd included amounts from affiliates that are beyond the amounts provided for in the annual incentive plans. AG/CUB Ex. 3.0 at 54. ComEd misrepresents Mr. Smith's testimony (ComEd Init. Br. at 72) by failing to acknowledge that he recommended allowing a significant portion of the costs, but demonstrated that normalizing and sharing the costs with shareholders is appropriate. In the 2009 test year, notes CUB, a year with a severe recession and high unemployment, ComEd exceeded the total it had spent on retention awards for the previous three years. AG/CUB Ex. 9.0 at 35. Mr. Smith testifies that Company policy is clear that management retains the right to modify or revoke its retention bonus policy at any time, but chose not to do so during this tumultuous time. AG/CUB Ex. 3.0 at 55. CUB avers that the Company has not explained why it was significantly more difficult to retain employees during this period of high unemployment than it was when the economy was healthier. Mr. Smith proposes a more reasonable, four-year average to normalize this expense.

Mr. Smith also recommends that Company shareholders share the cost of performance-based recognition awards 50/50 with ratepayers. Awards under this policy include cash awards up to $5,000, gift certificates, and other non-cash spot awards. *Id.* at 56. Given that these awards are discretionary and are designed to benefit both shareholders and consumers, Mr. Smith recommends 50/50 sharing of these costs. *Id.* CUB points out that the Company did not refute Mr. Smith's contention that performance-based recognition awards provide significant benefits to shareholders, rewarding employees for significant employee contributions to Exelon's success. *Id.* at 56. Like the retention awards described above, the Reward and Recognition policy also provides that the program may be modified or revoked at any time. *Id.* Again, the Company chose not to make changes during the test year.

CUB demonstrates that the total appropriate adjustment for perquisites and awards of $1.392 million jurisdictional. AG/CUB Ex. 3.0 at 54-56; AG/CUB Ex. 7.1 Schedule C-13.

Commission Analysis and Conclusions

The Company has failed to demonstrate that its requested amount of perquisites and awards is just and reasonable. We find it unlikely that it was necessary for ComEd to pay out more in these awards in 2009 than it had for the previous three years in toto. Therefore, we agree with Mr. Smith that this amount must be normalized using a four-year average.

h. 2009 Severance Expenses

CUB's Position

CUB recommends an adjustment to remove 2009 severance costs from the Company's revenue requirement, which the Company seeks to recover and amortize. AG/CUB Ex. 2.0 at 24. Mr. Effron shows that the savings retained by shareholders since the program was implemented in mid-2009 will be in excess of $25 million by the time rates from this case go into effect in June 2011. *Id.* The 2009 severance program cost the Company $14.4 million. *Id.* CUB avers that allowing the Company to recover 2009 severance expenses in this case would be double recovery—once from the savings already retained by shareholders, and a second time by consumers. *Id.*

Alternatively, CUB recommends that if the Commission does authorize the inclusion of 2009 severance costs, the amortization period should be 7.5 years rather than three years as the Company has proposed. *Id.* at 24-25. According to Mr. Effron, the amortization period must be extended to better match the realization of benefits of the program. *Id.* at 25. Ms. Houtsma argued that Mr. Effron did not justify a 7.5 year amortization period (ComEd Ex. 29.0 at 46); however, she does not dispute that benefits from the program should continue beyond just those years. AG/CUB Ex. 8.0 at 18. ComEd suggests is the basis of Mr. Effron's argument is that the savings won't be realized until those 7.5 years have passed. ComEd Init. Br. at 76. CUB avers that this is not accurate. Mr. Effron notes that savings from the program will continue at least another 7.5 years, therefore Mr. Effron proposes that if such costs are included in rate base, the amortization period for those costs should match that time.

According to CUB, ComEd's argument that disallowing these costs is single-issue ratemaking (ComEd Ex. 55.0 at 29) is a straw man argument. CUB states that while the Company would prefer to downplay the validity of Mr. Effron's arguments, along with Staff witness Mr. Tolsdorf who makes similar points, the Commission's duty is to evaluate each cost separately, and doing so does not constitute single-issue ratemaking.

The total adjustment Mr. Effron makes to ComEd's projected severance expenses reduces the Company's operational and maintenance expenses by $22,942,000 to the severance expense amortization. AG/CUB Ex. 7.1 Schedule C-4.

Commission Analysis and Conclusions

The Company's 2009 severance expense began accruing savings for the Company immediately, but those savings will not be realized by ratepayers until rates from this case go into effect in June 2011. Those savings more than offset the Company's expense, and no further recovery is reasonable.

i. Charitable Contributions

CUB's Position

Mr. Brosch proposes that the cost of test year charitable contributions that management elected to incur in the test year should be shared between ratepayers and shareholders. AG/CUB Ex. 1.0 at 47. CUB agrees that sharing those costs would provide ComEd with incentive to carefully prioritize its funding. *Id.* ComEd seeks cost-plus, full recovery regulatory treatment of its charitable contributions. *Id.* While CUB supports ComEd participating in charitable giving, CUB notes that the giving is just that—charitable. If ComEd expects its ratepayers to be charitable, then CUB believes that ComEd's shareholders should be as well. CUB also notes that if charitable contributions were not included in rates, then ratepayers would be left with more discretionary income from which they may be able to select and contribute to the charities of their choice. *Id.* at 47-48. Instead, ComEd collects from ratepayers and funds charities that might not be the charities ratepayer would prefer, and ComEd receives the benefit of the goodwill engendered by such giving. *Id.* at 47-48.

CUB indicates that ComEd receives other benefits as well, such as having its logo on materials distributed by the charitable organization and the benefit of listing that organization in its own promotional materials. *Id.* Mr. Brosch testified that he is not aware of any utility outside of Illinois, or any unregulated business, that is able to fund discretionary charitable contributions out of anything other than its earnings. *Id.* at 47. However, rather than proposing that shareholders should bear 100% of these contributions, Mr. Brosch has proposed that they may recover 50% from ratepayers. *Id.* ComEd acknowledges Mr. Brosch's argument that it has little incentive to hold down charitable contributions because it knows it can recover them dollar-for-dollar. ComEd Init. Br. at 77. With regard to Mr. Fruehe's statement that the 50% cutoff is "arbitrary," CUB argues that this issue is a matter of regulatory policy, and thus some discretion is necessarily involved. AG/CUB Ex. 7.0 at 31. CUB believes that ComEd attempts to distract from the true issue, whether the costs are reasonable, by arguing that the charities to which they contributed are *bona fide* charities, and that the Company is requesting less here than it did in its last rate case. ComEd Init. Br. at 76-77. CUB maintains that these are not relevant facts to the Commission's determination of whether the costs are reasonable to pass on to ratepayers. A disallowance is appropriate, and Mr. Brosch's proposal that ratepayers would bear even half of the expense is generous according to CUB.

Mr. Brosch's proposed adjustment is a reduction of $2,803,000 to reflect reasonable ratepayer funding of charitable contributions. AG/CUB Ex. 7.1, Schedule C-17.

Commission Analysis and Conclusions

While the Commission encourages ComEd to continue making charitable contributions, we agree with Mr. Smith that the whole amount ComEd contributed in 2009 is not reasonable to collect from ratepayers. A 50% reduction is appropriate, as the Company has the benefit of choosing the charities to which it contributes ratepayer funds and the Company solely enjoys the benefits of those contributions.

<u>j. Legal Fees – IRS Dispute</u>

CUB recommends that legal fees associated with an IRS dispute associated with the sale of fossil generating units in 1999 are non-jurisdictional and should be disallowed. AG/CUB Ex. 2.0 at 21-22, AG/CUB Ex. 8.0 at 13-14. CUB suggests that the Company has recognized as much by removing ADIT related to the sale from the deferred taxes deducted to plant in service in calculating rate base. AG/CUB Ex. 2.0 at 21. ComEd stated that it did so because "The tax being deferred relates to the gain incurred on the sale of fossil generating stations previously owned by ComEd, thus it is non-jurisdictional." *Id.* CUB argues that the legal fees associated with a dispute of the sale cannot be jurisdictional of the sale itself was not.

ComEd claims that because the Company used a general allocator to allocate expenses between transmission and distribution in Account 923, the account to which the legal fees were charged, it is appropriate to claim a portion of those fees as jurisdictional. ComEd Ex. 30.0 at 10. ComEd Mr. Fruehe acknowledges, however, that some individual items in that account are "more closely related" to particular functions. *Id.* CUB argues that the Company's choice to use a general allocator for this account is not a necessity, nor is it appropriate given that this significant cost is admittedly not properly allocated to ratepayers. CUB states that the Commission should not allow the Company to recover this cost which they admit has no benefit to ratepayers. This results in a reduction of jurisdictional operations and maintenance expenses by $2,187,000. AG/CUB Ex. 7.1 Schedule C-6.

Commission Analysis and Conclusions

We are not bound by the Company's choice to use a general allocator for the account in which these expenses appear. In light of the Company's admission that this expense has no relation to delivery services customers, this expense cannot be recovered from ratepayers. We accept Mr. Effron's adjustment to remove this expense.

<u>k. Professional Sporting Activity Expenses</u>

CUB's Position

The Company has requested that ratepayers reimburse executives for attending professional sporting events. They have included the costs of tickets, catering, and well-appointed skyboxes. AG/CUB Ex. 3.0 at 53-54. However, Mr. Smith notes that ComEd claims it is unable to provide any more detailed information, such as exactly how much was spent on catering, alcohol, etc. *Id.* at 54. CUB challenges ComEd's justification for inclusion of these expenses, which it claims are good for team building, development of customer relationships, and employee recognition. ComEd Ex. 30.0 at 11. CUB is questions just how many ComEd customers receive the privilege of having ComEd pay for their skyboxes to "build customer relationships," and why ComEd feels the need to build customer relationships in this matter at all considering they hold a monopoly on electric delivery service in their territories. CUB states that this expense is obviously not necessary for the provision of utility service, and that ComEd is free to treat its executives to lavish skyboxes on shareholders' dime.

ComEd fails to address the reasonableness of its professional sporting activity expenses, which include box seats tickets, catering, alcohol etc., instead simply arguing that it has classified most of the expense "below the line." This change was not made until hearing in this case. Tr. at 2445-2447. CUB states that the entirety of this expense is unreasonable to charge to ratepayers, and the remaining amount of $64,000 should also be disallowed.

Commission Analysis and Conclusions

We decline to allow any portion of sporting event ticket and catering event expense to be passed on to ratepayers. The Company states that it is classified most of this expense "below the line," but continues to request allowance of $64,000 in O&M and $8,000 in rate base. That remaining amount is disallowed.

l. Workforce Expense Reduction

This issue has been addressed above in the section entitled Wages and Salaries Pro Forma Adjustment.

6. Tax Repair Methodology – New IRS procedures

CUB Position

Mr. Effron testifies that the IRS recently issued a new Procedure, introducing a new method of tax accounting for repair charges. AG/CUB Ex. 2.0 at 28. The effect of the change is to enhance the current repair allowance deduction for certain expenditures, including "network assets," that are capitalized for financial reporting purposes. *Id.* at 28-29. According to CUB, the change would decrease the income taxes currently payable and its authorization is automatic; however, ComEd has not implemented the change. *Id.* at 29. The Company states that it, along with other utilities, is awaiting further clarification from the IRS on this point. ComEd Ex. 29.0 at 38-39. However, Mr. Effron testifies that the majority of other electric transmission and distribution companies have taken advantage of the enhanced income tax deduction. AG/CUB Ex. 8.0 at 20.

CUB contends that absent any mechanism to preserve the benefits of the increased tax deductions for ratepayers, shareholders will receive a windfall if the Company decides to make the changes after this case. AG/CUB Ex. 2.0 at 33. ComEd claims that the benefits will simply serve to reduce the non-recovery of new investments that ComEd will make between now and its next rate case. ComEd Ex. 29.0 at 29-30. CUB counters that if this was a plausible argument, then ComEd could choose not to include any rate base deductions in its rate case, such as depreciation and ADIT, on the theory that they would surely be balanced out by investments they would make later. Mr. Effron states that the benefits of the repair allowance may well be more than the investments ComEd will make before its next rate case once depreciation and ADIT are considered. AG/CUB Ex. 8.0 at 20.

ComEd states that ratepayers should not retain the benefit of this deduction because it records all of its accumulated deferred income taxes in separate accounts which account for the tax timing differences. ComEd Init. Br. at 83. CUB maintains that this does not explain why the Company could not keep a record of any increase to the ongoing repair allowance decision from the effective date of the accounting change and then credit to customers the cumulative effect of the change, with appropriate carrying charges. AG/Cub Ex. 2.0 at 33.

Mr. Effron recommends that if ComEd implements this change before the record in this case closes, then its rate base should be adjusted. AG/CUB Ex. 2.0 at 33. Otherwise, CUB requests that the Commission order the Company to: 1) maintain the effect on any Section 481(a) adjustment related to the new repair allowance in a reserve account; and 2) keep a record of any increase to the ongoing repair allowance decision from the effective date of the accounting change. *Id.* CUB states that the cumulative revenue requirement effect of the change, with appropriate carrying charges, should then be credited to customers at the time of the Company's next rate case. *Id.*

Commission Analysis and Conclusions

We agree with Mr. Effron that the Company should: 1) maintain the effect on any Section 481(a) adjustment related to the new repair allowance in a reserve account; and 2) keep a record of any increase to the ongoing repair allowance decision from the effective date of the accounting change.

7. Depreciation of Intangible Plant

CUB's Position

ComEd has requested amortization on additions to post-test year intangible plant during the *pro forma* period. The Company agrees with CUB that certain assets, which began their amortization period in 2002, will be fully amortized by the end of the *pro forma* period. ComEd Init. Br. at 84., ComEd Ex. 55.0 2nd Rev. at 34. CUB avers that, under the matching principle, as with other *pro forma* calculations, if *pro forma* amortization is included in rates then assets becoming fully-amortized during the *pro forma* period must correspondingly reduce rates. AG/CUB 8.0 at 19. Certain assets of intangible plant which began their amortization period in 2002 will be fully amortized by March 31, 2011. *Id.* ComEd's argument against removing those fully-amortized assets from rate base is that ComEd made other investments in late 2009 should balance out the amortized assets. *Id.* CUB argues that the end of 2009 was a part of the test year, and the Company included all 2009 investments in rate base, so its assertion that "A full year's effect of the depreciation on these projects would more than offset the impact of the lower amortization related to the fall off of the older projects" is not justification for keeping fully-amortized assets in rate base. CUB maintains that allowing such would result in recovery well beyond the Company's actual expense for these assets.

CUB calculations show that disallowing continued amortization of 2002 intangible plant, reducing pro forma amortization expense by $4,721,000, and elimination of the amortization of 2005 intangible plant, reducing pro forma amortization expense by $908,000 results in a total reduction to amortization expense is $5,629,000, which on a jurisdictional basis, this reduces pro forma amortization expense by $4,987,000. AG/CUB Ex. 8.0 at 19, AG/CUB Ex. 7.1 Schedule C-7.

Commission Analysis and Conclusions

We decline to allow continued recovery for assets whose amortization period will have ended by the end of the pro forma period. This would result in unjust over-recovery. The "offset" of new assets which the Company claims is not reason to continue to collect on an older, fully-recovered asset. We agree with the recommendation of Mr. Effron.

9. Illinois Electricity Distribution Taxes

CUB's Position

CUB argues that the Company has taken an inconsistent position in using weather-normalization for one portion of this calculation, the gross tax estimate, but a six-year average for the other part, credits received from the Illinois Department of Revenue. AG/CUB Ex. 1.0 at 50-51. Mr. Brosch has proposed an adjustment, based on ComEd's analysis, to include the Company's estimation of its 2009 gross tax. AG/CUB Ex. 1.0 at 50. The Company, however, objects to the inclusion of that information in calculations for purposes of this case because the Company does not actually receive the 2009 credit in 2009. ComEd Ex. 30.0 at 11-12.

CUB argues that both the tax and the credit should be calculated by the same standard, and the Company should not be permitted to choose actual figures for one and weather-normalized figures for another simply because it increases its recovery. CUB Init. Br. at 40. CUB believes that ComEd's method is inconsistent and amounts to cherry-picking calculation methods in order to produce more favorable results to the Company. CUB Reply Br. at 27. Mr. Brosch calculates a reduction of $1,387,000 by using a consistent approach to both the gross tax and the credit. AG/CUB Ex. 7.1 Schedule C-19.

Commission Analysis and Conclusions

We agree with AG/CUB witness Mr. Brosch that the company incorrectly used a weather-normalized 2009 tax and a six-year average to calculate its 2009 credit. The Company's 2009 actual tax paid and 2009 estimated credit are more accurate and more reliable. We accept Mr. Brosch's recommendation to use this more consistent approach.

11. Regulatory Asset Relating To Tax Liability for Medicare Part D (Uncontested b/t Company and Staff)

CUB does not take issue with the establishment of a regulatory asset for this purpose, but disagrees with the Company's proposal to amortize that asset over only three years. AG/CUB 2.0 at 26. The Company claims that could leave ComEd with insufficient funds to make the required tax payments when they become due. ComEd Init. Br. at 87. Mr. Effron explains that the benefits of the subsidy received in just 2009 will be realized over approximately eleven years, and the Company received benefits for years prior as well. AG/CUB Ex. 2.0 at 25. Mr. Effron testifies that his approach is consistent with when the federal government remits the cash subsidies to ComEd. AG/CUB Ex. 8.0 at 18. CUB avers that the regulatory asset should be amortized over at least ten years (*Id.*) resulting in a downward adjustment of $2.207 million. AG/CUB Ex. 7.1 at Schedule E.

Commission Analysis and Conclusions

We agree with Mr. Effron that, because the benefits of the 2009 tax subsidy will be realized over a number of years, so too must the amortization period of that asset run that same time period. Because the Company will enjoy the benefits of the asset for at least ten years, we accept Mr. Effron's recommendation that the asset should be amortized over ten years as well.

13. Income Taxes (Derivative Adjustments)

CUB explains that the Company is permitted to deduct interest expenses for income tax purposes, and the Commission does not typically approve a specific amount of debt as "reasonable" for recovery for that purpose because it is derivative of the overall rate base and weighted cost of capital. AG/CUB Ex. 1.0 at 44. However, CUB maintains that, in its order, the Commission can quantify and synchronize the amount of interest being allowed recovery by applying the weighted cost of debt to the approved rate base. *Id.* Because AG/CUB is proposing a revised level of Rate Base for ComEd, the resulting change in deductible interest for income tax purposes is significant. *Id.* Mr. Brosch recommends an adjustment of $14.306 million based on the rate base recommended by AG/CUB witnesses. AG/CUB Ex. 7.1 at Schedule D, AG/CUB Ex. 7.1 at Schedule C-15. No party has objected to the Commission quantifying the amount of interest in its final order.

Commission Analysis and Conclusions

We find that the deductible interest for income tax purposes should be calculated on the rate base correctly calculated by AG/CUB witnesses.

VII. RATE OF RETURN

A. OVERVIEW

CUB argues that the Commission is tasked with equitably balancing the needs of the company—that is, what investors require—with the requirement that rates be affordable for customers. 220 ILCS 5/1-102. Therefore, CUB believes the Commission must be very careful not to award a higher rate of return than would actually be required in true market circumstances so it does not unfairly burden ratepayers. CUB avers that the final decision must be based on the facts and evidence put forth in this case: it must be confined to the legal standards underpinning the regulatory process.

E. COST OF COMMON EQUITY

CUB's Position

CUB characterizes the testimony of the Company as alarmist, and states that ComEd is not a relatively risky investment. Furthermore, CUB notes that the Company has made requests in this case that would further reduce investors' risk by increasing fixed cost recovery. ComEd is requesting that the Commission approve a base return on equity of 11.3%, the product of an 10.9% "base return on equity" and a 0.40% adjustment to the allowed return on equity related to the implementation of energy efficiency and demand response programs. ComEd Init. Br. at 89. AG/CUB witness Chris Thomas determined that the appropriate return on equity ("ROE") for ComEd is 8.94% based upon his analysis using models commonly adopted by the ICC for this task and the longstanding legal framework determined by two fundamental U.S. Supreme Court decisions. AG/CUB Ex. 4.0 at 37. CUB notes that the Company's request is well above other estimates in this case as well: Staff, 10.0%; IIEC, 9.65%. Staff Ex. 5.0 at 10-35, IIEC Ex. 4.0 at 2.

CUB discusses the importance of the two key decisions on this topic, the first being *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia,* 262 U.S. 679 (1923) ("*Bluefield*") and the second being the *Federal Power Commission et. al. v. Hope Natural Gas Co.,* 320 US 591 (1944) ("*Hope*"). Together, says CUB, the *Hope* and *Bluefield* decisions establish that utilities are entitled to the opportunity to earn a fair return on their prudent and reasonable investment that is commensurate with the returns earned by other firms of comparable risk. CUB avers that the Commission's decision must be based upon an evaluation of the relative riskiness of the Company. CUB states that the evidence presented in this case shows that investors perceive utilities as less risky than other investments, as demonstrated by the fact that utility equities have not fallen as far as the overall market or have recovered to a greater extent than the market generally. *See* AG/CUB Ex. 4.0 at 12, 31; IIEC Ex. 1.0 at 7-8. According to CUB, this relative stability of utility equity validates intervenors' findings of lower risk and lower cost for utility equity.

CUB states that evaluating the relative risk involved in an investment is by necessity a point-in-time evaluation: the measure of a fair return will change over time as the equity markets change. To make this determination, says CUB, the Commission has relied on two well-established financial models – the Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM") – which attempt to approximate what return would induce someone to invest in ComEd if that option were available based on how risky an investment ComEd is perceived to be. Mr. Thomas identified a few simple principles that can help the Commission determine the appropriate ROE:

- To an investor, "risk" is the probability that an investor will not receive a sufficient return on their investment.
- Risk is important because of the correlation between the riskiness of an investment and the expected payout that investors require for making that investment — low risk investments require lower rates of return to entice investors.
- Utilities are generally less risky than other firms in the economy.
-

AG/CUB Ex. 4.0 at 4.

CUB explains that within the American economy, public utilities like ComEd have a relatively unique status: they have exclusive franchises to provide utility service in their service territories in exchange their rates are regulated by public utility commissions like the ICC. CUB maintains that this structure affords utilities the opportunity to earn a fair return on their prudent and reasonable investment that is commensurate with the returns earned by other firms of comparable risk, as established by the *Hope* and *Bluefield* decisions. Of course, CUB contends, this is not a risk free arrangement. Utility investments are still subject to some degree of risk; utilities often cite the after-the-fact prudence review as a risk to their ability to recover their investments. However, CUB states that the protection afforded by public utility regulation reduces the risk of utility investments and allows them to access capital at cost lower than the costs incurred by other firms.

AG/CUB witness Mr. Thomas explains that since the Commission's Final Order in ComEd's last rate case, issued September 10, 2008 in ICC Docket No. 07-0566, the capital markets have been rather chaotic. He explains that some have referred to this market turmoil as the worst since the 1929 Great Depression because there have been dramatic declines in equity valuations, numerous bankruptcies (especially in the financial sector), and an overall instability in the economy during the last two years. While the economy has begun to recover, Mr. Thomas points out that the Federal Reserve has noted that the recovery is slow and projected to stay that way. Mr. Thomas notes that utility companies have generally fared better than the overall economy. Investor confidence in the sample utilities remains strong relative to the general economy. Both Dr. Hadaway and Mr. Thomas prepared summaries of data which demonstrate the same conclusion. Dr. Hadaway highlights the differences in the adjustment methodologies applied by Yahoo Finance and S&P in presenting stock price information and the S&P 500 index, and he presented "corrected" stock prices changes in the following table:

Change in Stock Prices

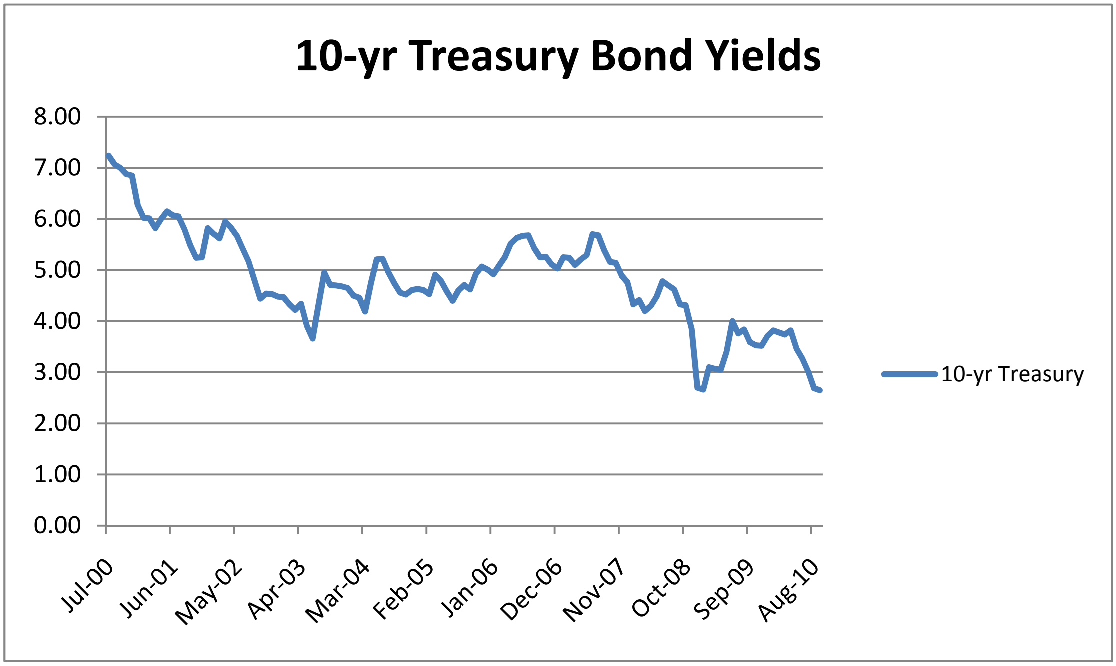
	(1) High Price	(2) Low Price	(3) Present Price	(4) High to Low	(5) Low to Present	(6) High to Present
S&P 500 Index	$1,565.15	$ 676.53	$1,165.15	-56.8%	72.2%	-25.6%
Dow Jones Utility Average	$ 520.89	$ 290.68	$ 403.91	-44.2%	39.0%	-22.5%
Thomas Utility Prices	$1,375.11	$ 837.31	$1,275.25	-39.1%	52.3%	-7.3%

Notes:
Column 1: Closing price as of October 9, 2007, excluding dividends.
Column 2: Closing price as of March 9, 2009, excluding dividends.
Column 3: Closing price as of October 8, 2010, excluding dividends.
Column 4: Compound growth from column 1 to column 2.
Column 5: Compound growth from column 2 to column 3.
Column 6: Compound growth from column 1 to column 3.

ComEd Ex. 37.0 at 28, 30.

Mr. Thomas explains that the companies in this analysis declined by 39.1% at a time when the overall stock market declined by 56.8%. Even as the market was still 25.6% below its highest level, Mr. Thomas finds that the sample utilities were only 7.3% below their collective high. According to CUB, this date shows that investor confidence in public utilities is higher than it is in other firms in the economy.

Mr. Thomas used Treasury bond returns as a comparison. He explains that there has been a distinct downward trend of Treasury bond returns as investors seek to reduce their exposure to risk and invest in low risk securities. Mr. Thomas provided the following chart that demonstrates this phenomenon:



AG/CUB Ex. 4.0 at 12.

CUB agrees that utilities generally spend more of their cash flow on capital expenditures than other industrial firms. However, CUB avers, electric utilities like ComEd are monopolies which are the only entities obligated to deliver electricity, a service essential to almost every aspect of American life. According to CUB, in exchange for this obligation the utilities can take advantage of the general rate-making process, which allows them the opportunity to request an increase in their prices to customers through an increase in delivery services rates. CUB states that, in the context of a rate case like this one, a utility must show that its investments and expenses are reasonable and prudent and utilities often cite this prudence review as a source of risk. CUB points to the Commission's recent finding that a utility "largely controls the outcome of any such prudence review so long as it acts prudently in attempting to recover unpaid amounts." ICC Docket No. 09-0306 (cons.) Final Order at 218. CUB contends that the risk that a utility will not recover its expenses is mitigated by the expectation that the utility will act reasonably.

CUB notes that the regulatory structure in Illinois provides monopoly utilities like ComEd even more cost recovery mechanisms which further reduce the risk an investor would not get a return. For example, ComEd passes through to consumers the price of electricity supply purchased by the Illinois Power Agency, 220 ILCS 5/16-111.5; costs associated with energy efficiency programs, 220 ILCS 5/8-103; costs associated with services to alternative electric suppliers, 220 ILCS 5/16- 118; and can recover their uncollectible expenses through a rider mechanism, 220 ILCS 5/16-111.8. CUB explains that these rate mechanisms increase utilities' ability to recover expenses and stabilize cash flow. CUB points to the Uncollectibles Rider, 220 ILCS 5/16-111.8, as an example. That rider allows an electric utility like ComEd to recover through an automatic adjustment clause tariff incremental differences in its uncollectible accounts. CUB avers that ComEd faces less risk of recovering its expenses, since the cost of any uncollectible accounts is shared amongst all ComEd customers and recovered through an automatic adjustment charge.

CUB notes that this Commission has already concluded that there is a benefit to electric utilities with the adoption of the uncollectible riders, and that a portion of that benefit should accrue to ratepayers through a reduction in the cost of common equity. ICC Docket No. 09-0306 (cons.) Final Order at 218. Moreover, CUB states, ComEd itself proposed a rate design mechanism that will further reduce its risk of failing to recover its fixed costs (according to ComEd witness Ross Hemphill "[A straight fixed-variable ("SFV")] rate design establishes fixed and variable charges that track the fixed and variable costs of serving each customer or customer class,"). ComEd Ex. 14.0 at 182-184. For purposes of estimating an appropriate ROE for ComEd, CUB finds that any increase in the amount of fixed cost recovery for the Company reduces the likelihood that the Company will not recover its costs, which in turn further decreases risk for investors.

CUB argues that Mr. Fetter's "diatribe" about the importance of credit ratings should not influence the Commission's decision, as CUB explains that it is impossible, and inherently speculative, to peg an approved rate of return or rate increase to credit rating expectations. CUB states that the Company has not presented any specific evidence to demonstrate that it would be unable to attract capital on reasonable terms, thus the Commission should not consider the testimony on this issue as evidence. CUB notes that the only evidence in the record on the effect of an ICC decision on a utility's credit ratings was a discussion of whether credit ratings agencies had changed the ratings of the Ameren Illinois Utilities following the ICC's decision in ICC Docket No.s 09-0306 (cons.), Tr. at 1812. The ratings agencies did not change Ameren's ratings. *Id.*

CUB explains that the only model ComEd relies on that the Commission has typically accepted is the DCF approach, and the Commission has explicitly denied the various risk premium and comparable earnings tests proposed by the Company. ComEd witness Carl Seligson uses different risk premium and comparable earnings tests, both of which CUB explains have been previously rejected by this Commission. ComEd Ex. 12. CUB avers that the Commission's analysis in recent cases has relied on combinations of DCF and CAPM analyses. AG/CUB Ex. 4.0 at 17.

CUB argues that the Company's testimony does not justify the Company's proposed rate of return on common equity ("return on equity," or "ROE"). CUB notes that the Company's request is well above the range of estimates put forth by various Staff and Intervenors. The difference between the ROE recommendations made by the various witnesses in this case exists for a variety of reasons, but the most significant are related to company growth expectations. Mr. Thomas performed analyses which CUB believes accurately account for the actual potential growth and investor expectations. Mr. Thomas recommends that the Commission adopt an ROE of 8.94%.

2. Discounted Cash Flow Analysis

AG/CUB witness Thomas performed four different DCF analyses: two different constant growth analyses using the historic and projected internal growth rate for the sample utilities, and two different analyses using the non-constant growth DCF model starting at the historic and projected internal growth rates for the sample utilities. Like the IIEC and Staff witnesses in this case, Mr. Thomas concluded that a non-constant growth DCF analysis would be most appropriate. Mr. Thomas explained that expected future growth is highly uncertain given turmoil in the credit markets, which creates uncertainty for investors. This makes investors focused on short-term changes in the equity markets simply because their long-term valuation models aren't able to accurately predict returns in a market where existing valuation models can't take into account deep, broad-scale declines in value like that which occurred in the recent recession. CUB avers that both forecasted and historical growth rate information become highly subjective measures of expected future growth for individual firms. CUB notes that the Commission has already recognized this fact, and begun using a non-constant growth model. 09-0306 (cons.) Final Order at 215 (noting that as analysts projected growth rates for utilities have exceeded the projected growth rate of the U.S. economy as a whole).

Mr. Thomas testifies that the growth rate in the DCF model represents the sustainable growth that investors expect in their investment resulting from expected increases in a company's earnings. That growth rate must be consistent with, and supported by, the economic conditions and dividend payout policies expected to occur. Mr. Thomas states investor requirements for future dividends and rates of growth cannot be found in the pages of the Wall Street Journal and plugged into the model. The analysis is further complicated by the current market upheaval and by the fact that the Company does not have publicly traded stock to provide some type of current, objective dividend and price information.

Mr. Thomas avers that the most relevant measure of growth for the Commission to consider is the internal growth of the sample utilities. In general, company management is expected to retain some of the company's earnings within the business. Such retained capital is commonly referred to as "retained earnings." Retained earnings are used by management to fund operations and to grow the business by investing in new facilities or more efficient processes that will produce greater future returns. This type of growth is known as "internal" growth because it comes from the capital retained within the business. Evaluating a company's internal growth can help the Commission to avoid the type of upward bias produced by the use of analysts' growth estimates.

Mr. Thomas used the following fundamental growth rate formula:

Earnings Growth = b x r where
b = the fraction of earnings not paid out as dividends (the "retention rate"), *i.e.* one minus the dividend payout ratio, and
r = the expected rate of return on common equity

AG/CUB Ex. 4.0 at 24.

In his analysis Mr. Thomas used two growth rates. AG/CUB Ex. 4.0 at 25. The first calculated the historic internal growth rate for each of the sample utilities over the period from 2004 to 2009. AG/CUB Ex. 4.0 at 25-26. The second calculated the anticipated internal growth for each sample utility based upon expectations from Value Line. AG/CUB Ex. 4.0 at 26. He then used the overall U.S. Gross Domestic Product ("GDP") growth rate as a baseline for comparison of his DCF results. Over the most recent 40-year period[1], GDP grew by 6.93%: from 1969 to 1989, the growth was 8.99% and from 1989 to 2009, the growth was 4.86%. *Id.* In checking his results, Mr. Thomas used a 20 year historical average because the most recent period of analysis, including the most recent multi-year economic crisis, shows far less growth in GDP. *Id.*

ComEd rejects this notion "inappropriate and biased." CUB notes that a 4.86% estimate as being too low, is actually above the published consensus economist estimates of GDP growth. Based on its latest issue, the consensus economists' published GDP growth rate outlook is 4.8% to 4.7% over the next 5 to 10 years, respectively. IIEC Ex. 1.0 at 25. Given this data, and the fact that Staff witness Michael McNally relied on a 5.0% estimate of GDP growth, CUB argues that Dr. Hadaway's 6% GDP growth estimate is easily the outlier.

Mr. Thomas's complete results are summarized below:

	Hadaway Analysts' Growth	**Historic Internal Growth**	**Projected '13-15 Internal Growth**
Sample Average	5.59%	3.74%	4.42%

Based on Mr. Thomas's analysis, CUB finds that the internal growth rates for the sample utilities are reasonable in light of anticipated growth in GDP; do not require continued long-run earnings above the cost of capital; and the internal growth method calculates long term growth rates based on historical and projected dividend payout ratios that are consistent with the capital expenditure growth rate and the return on equity.

Mr. Thomas states that analyzing how a company's earnings are expected to grow over time – the amount of cash that a company has to return to its shareholders, or to invest in expanding its operations – is one measure investors use to assess the overall health of the company, how it is expected to grow, and ultimately how risky investing in a given company might be. According to Mr. Thomas, if a company chooses to retain less capital and pay out greater dividends, or retain more capital and retain payout smaller dividends, there is a definite effect on both dividends and growth. In all situations where the dividend payout ratio is not constant, the DCF model will produce inaccurate results. When dividend payout ratios decline, Mr. Thomas states, investors expect more growth to come from earnings because more capital has been retained for internal investment in the business. As a result, the DCF model will overstate the cost of equity. Similarly, an increasing dividend payout ratio will cause investors to expect less growth from earnings, and the DCF will understate the cost of equity. When these ratios are expected to change, using only reported analysts' earnings growth rates will result in inaccurate estimates of the cost of equity. CUB avers that Mr. Thomas's method, because it considers such changes in payout and retention ratios, is more accurate than the Company's. Dr. Hadaway proposed a slightly higher dividend yield than the one used by Mr. Thomas. ComEd Ex. 11.4. CUB states that the Commission should reject his proposal because comparing dividend yields in a vacuum doesn't provide any valuable information. CUB argues that Dr.

[1] 1969-2009.

Hadaway's decision to single out the differences in dividend yields obfuscates the issues in this case. Mr. Thomas notes that any differences in the dividend yield are merely derivative of other the other issues identified by the experts in this case. The dividend yield is the projected dividend (current dividend times the expected growth rates) divided by the stock price. It is the difference in these factors that accounts for the differences in the dividend yield. Therefore, CUB avers any differences in the dividend yields used by Dr. Hadaway and Mr. Thomas are driven by the relationship of dividends to stock prices when the analyses were performed and the growth rates used in the respective analyses.

The below table compares the results of Mr. Thomas and Dr. Hadaway:

Comparing Results

	Thomas	Hadaway Average
Non-Constant Growth DCF		
Analysts' Growth		11.10%
Historic Internal Growth	8.98%	
Projected Internal Growth	9.65%	
Constant Growth DCF		
Analysts Growth Rates		10.70%
Long-term GDP		11.10%
Historic Internal Growth	8.22%	
Projected internal Growth	8.92%	
Recommendations	**8.94%**	**11.10%**

AG/CUB Ex. 4.0 at 34.

CUB notes that Dr. Hadaway calculates an 8.99% ROE using Staff witness Michael McNally's 10% estimate and the average retention rate of Mr. McNally's proxy sample. ComEd Ex. 37.0 at 18. Dr. Hadaway claims that this inconsistency with Mr. McNally's recommendation implies that the "BxR" method used by both Mr. McNally and Mr. Thomas should be rejected. *Id.* CUB contends that Dr. Hadaway's calculation confirms Mr. Thomas' 8.94% ROE estimate and highlights the bias introduced into Commission proceedings from analyses relying heavily on analysts' growth rates, as Mr. McNally does. Staff Ex. 5.0 at 15&17. CUB points to the 5.53% analysts' growth rate used in Mr. McNally's constant growth DCF and in the first stage of his non-constant growth DCF. This is a rate above the 5% long-term growth in GDP that Mr. McNally assumes. Staff Ex. 5.0 at 15. Mr. Thomas stresses that evaluating the Company's internal growth can help the Commission to avoid the type of upward bias produced by the use of analysts' growth estimates.

CUB avers that Dr. Hadaway's proposed growth rates would require that the companies in the sample groups exceed their own historic growth, and also exceeded growth in GDP. Mr. Thomas urges that the Commission cannot rely on this analysis because it relies on growth expectations that are not sustainable in light of expected growth in GDP, expected dividend payout ratios, and would require sustained earnings in excess of the true cost of capital. Moreover, Mr. Thomas argues that Dr. Hadaway's two key "required assumptions" for his analysis, constant earnings and retention rates, are not met in reality. ComEd Ex. 37.0 at 27.

Mr. Thomas performed a non-constant growth DCF analysis using a multi-stage growth analysis. AG/CUB Ex. 4.0 at 29. For the short term, he assumed that for a period of five years, the companies in the sample will grow at their (average historic and projected) internal growth rate. *Id.* After the end of the initial five year period, he assumed that there will be an additional five year period of transition, where growth slows from its historic levels before eventually settling at a long term level that is equivalent to the historic growth in GDP over the last 20 years. *Id.* Effectively, Mr. Thomas created a three-stage DCF model, similar to methods used by Staff in prior cases, and which is summarized in the chart below:

DCF Results

	Multi-Stage DCF		**Constant Growth DCF**	
	Historical BxR	*Projected BxR*	*Historical BxR*	*Projected BxR*
Sample Average	8.98%	9.65%	8.22%	8.92%
	Wtd Avg	**8.94%**		

AG/CUB Ex. 4.5. The DCF model produces an 8.94% rate of return on Common Equity. AG/CUB Ex. 4.0 at 29.

3. CAPM Analysis

Mr. Thomas testifies that the CAPM, like the DCF, is predicated on two key assumptions: (1) that in the market, investors are compensated only for non-diversifiable risk, quantifiable as a uniform EMRP, and (2) that beta is an accurate measure of the relative risk of an individual security when compared with the overall market. CUB notes that in recent cases, the Commission has made it clear that in determining the cost of equity, it prefers to use the mad-point of both the CAPM and DCF models (See ICC Docket No. 09-0319, Final Order at 113, ICC Docket No. 09-0306 (cons.), Final Order at 220). CUB avers that while it is not perfect, the CAPM can be useful to verify the results of independently performed DCF analyses, which is what Mr. Thomas did. CUB notes that despite the Commission's traditional reliance on a CAPM analysis, no ComEd witness undertook a CAPM analysis.

CUB avers that the Commission has traditionally accepted raw beta estimates, adjusted for mean reversion, as valid CAPM inputs. Commonly relied on by Value Line, this adjustment for an assumed reversion is one of the principal sources of the upward bias in Value Line betas. Based on this analysis, AG/CUB Ex. 4.6, which is summarized below, Mr. Thomas used a beta of 0.59:

Beta Analysis

VALUE LINE			

	Reported	*Unadjusted*	**YAHOO**	**ZACKS**	**GOOGLE**
Sample Average	0.70	0.55	0.56	0.56	0.56

Average (VL Adjusted)	**0.59**
Average (VL Unadjusted)	**0.56**

The EMRP represents the premium, above the risk-free rate, that investors expect when they take on the risk of an investment in the market portfolio, or the universe of potential investment opportunities available to investors. Mr. Thomas states that there are two main approaches to specifying the EMRP input to CAPM analyses – using EMRP estimates derived from the academic studies of market performance or using EMRP estimates calculated for particular situations or cases. Mr. Thomas used three different approaches in his CAPM analysis:

- An EMRP based upon the financial literature, as he has proposed in previous cases before the Commission.
- An EMRP based upon the decision the Commission made in the recent Ameren rate case; and,
- An EMRP based upon the testimony of Mr. Seligson (ComEd Ex. 12.0 at 207).

These three methods produce the following results:

CAPM RESULTS

	Literature	**Seligson***	**09-0306 Final Order #**
RF	3.72%	3.72%	3.72%
EMRP	5.00%	6.70%	8.98%
b	0.59	0.59	0.59
CAPM	**6.69%**	**7.69%**	**9.05%**

* ComEd Ex. 12.0 at 207
# Staff Ex. 6.0, Schedule 6.7

AG/CUB Ex. 4.0 at 33.

Mr. Thomas' CAPM analysis demonstrates that the appropriate ROE for a company like ComEd is in the range of 6.69% to 9.05%. *Id.*

4. Alternative ROE Analyses

ComEd witness Seligson presented two additional analyses, both of which CUB notes have already been rejected by the Commission in prior cases. CUB cites the Commission decision in a recent Peoples Gas rate order:

> The Commission will not consider the results of the Utilities Risk Premium model that only the Companies have employed. We have repeatedly rejected this model as a valid basis on which to set return on equity. Our view remains unchanged.

ICC Docket No. 09-0166, Final Order at 128 (January 21, 2010).

CUB avers that the Commission should, as it has in the past, decline the Company's request to use other states' decisions. In previously addressing this issue, the Commission stated;

> At several places in their evidence and briefs, the Utilities compare the ROE's recommended here with the ROEs approved in previous cases by this and other commissions. E.g., NS-PGL Ex. PRM-2.0 at 3-6. They assert that previously approved ROEs serve as "guideposts" for our analysis in these cases and insist that they "are not arguing that their returns should be based on the authorized returns of other utilities." NS-PGL BOE at 25. The Commission doubts that the Utilities' return comparisons were offered without the expectation that our decision-making would be affected by them. The Utilities are presumably reluctant to directly press for comparison-based ratemaking because of our previous rejection of that approach. In Commonwealth Edison's most recent rate case, we said:
>
> > ComEd asserts its cost of equity should reflect the costs of equity recently approved for electric utilities in the United States. The cost of equity appropriate to ComEd, however, is specific to that utility. ComEd may not simply adopt the cost of equity set for other utilities scattered around the country, for which the factors and circumstances are not necessarily similar. Rather, pursuant to Section 9-201 of the Act, ComEd must prove that its proposed cost of equity is just and reasonable. Commonwealth Edison, Docket. No. 05-0597, 1181 Order, at 153 (June 6, 2006).

Commission Final Order in Docket No. 07-0242, at 89-90. Thus, the Commission previously – and correctly – expressly rejected similar comparable earnings analyses and it should likewise do so here.

Commission Analysis and Conclusions

Based on the testimony and evidence provided by Mssrs. Thomas, Gorman and McNally, we find that as a regulated utility, investors view ComEd as relatively low-risk. Utility equities have not fallen as far as the overall market and have recovered to a greater extent than the market generally, demonstrating their relative stability. We decline to give merit to the Company's testimony regarding the "regulatory climate" in Illinois and its interaction with our decision in this case. The Commission has discussed that issue specifically in another case involving ComEd, ICC Docket No. 10-0138, where ComEd had presented very similar testimony as to the "negative regulatory climate" in Illinois. The Commission determined that testimony, very similar to that presented here, was not persuasive:

> [The testimony] that when investors see that a prudence review of any cost is involved, they assume that some of those costs are at risk of disallowance. Yet, [the witness] presented no facts indicating that this Commission should rely upon what investors think or might think, in order to determine the rate of return

> involved here. ComEd posits no facts indicating that appealing to investors that do not understand what a prudence review is would be something that is within this Commission's purview or even within its statutory jurisdiction.
>
> Also, Ms. Abbott's opinion regarding investors' alleged caution regarding prudence reviews overlooks the fact that Standard & Poor's finds that a true-up mechanism effectively eliminates credit risk. Standard & Poor's also finds that a true-up mechanism provides strong credit support that has withstood 'AAA' stress criteria. (*See*, Staff Ex. 8.0 at 4). While Ms. Abbott relies upon credit-rating agencies like Standard & Poor's for other opinions she expressed, she does not explain why investors should ignore Standard & Poor's in this regard. Both ComEd and Ms. Abbott have attempted to differentiate transition bonds, in large part, because those bonds were AAA-rated.
>
> [T]estimony regarding the negative regulatory climate regarding Illinois utilities overlooks the fact that this Commission has been, for a long period of time, dedicated to ensuring that, only reasonable and legally-recognizable, costs are passed on to ratepayers. The fact that this Commission does not compare favorably to some other state regulatory commissions in similar positions is merely demonstrative of this Commission's efforts on behalf of the consuming public to ensure that all costs that are passed on to the general rate-paying public are reasonable.
>
> Additionally, Ms. Abbott acknowledges the fact that ComEd's current rating reflects the Illinois regulatory environment. (Tr. 85). This is some indicia that Illinois utilities, with ComEd in particular, are not suffering as a result of the negative regulatory climate that she claims to exist in Illinois.

In re Commonwealth Edison, ICC Docket No. 10-0138 Amendatory Order at 49-50 (February 9, 2011).

CUB acknowledges that the cost of equity determination involves some subjectivity, as evidenced by the parties' differing conclusions using the same DCF model. We find Mr. Thomas's calculations to best imitate the current market, which is in a different condition than when ComEd's last rate increase was approved. We must base our decision on what investors today would require, and while the growth forecasts Dr. Hadaway shows unwarranted optimism, while Mr. Thomas's growth rate assumptions are the most realistic based on current conditions.

As we have done in recent cases, we find that averaging the results of the DCF model with those of the CAPM is the most reliable approach. Despite our reliance on this method, ComEd chose not to perform a CAPM analysis. Of the CAPM models presented, we agree with Mr. Thomas's evaluation of the volatility of ComEd common stock as compared to the market (the input of which is the "beta coefficient") and his reasonable approach to the EMRP.

ComEd has presented no compelling evidence that use of any alternative ROE analyses produces a more reliable result than what which we have typically relied upon. We have rejected these methodologies before and decline to adopt them now.

F. Adjustments to Rate of Return

1. Compensation for Energy Efficiency Programs

CUB questions Ms. Tierney's characterization of the "significant risk" that the Company will not recover regarding its chances of recovering its authorized return if it is successful in meeting its legislative energy efficiency targets. Though Ms. Tierney acknowledges that a future test year could address the use of forecasted billing determinants to set new rates could account for the effect of energy efficiency and demand-response programs, the Company has simply stated that it chose differently. ComEd Ex. 39.0 at 5. CUB avers that Ms. Tierney fails to demonstrate why the Commission should adopt her recommendation of an ROE "adder."

CUB notes that Ms. Tierney did not attempt to quantify the effect of the risks she claims are present. She did not determine the correct amount of basis points to add in the context of the rate structure ComEd was proposing. She did not address why the only party who can select a test year, ComEd, determined a future test year would be insufficient for its purposes. The only thing Ms. Tierney examined was whether, in her opinion, ComEd's proposal to include a 40-basis point addition in its ROE recommendation in the context of a straight fixed variable rate design was reasonable. Tr. at 1821.

CUB maintains that the Commission should reject ComEd's request. As Mr. Thomas notes, if the Company is truly concerned about the effects of the legislative mandates on its delivery services revenue and cost recovery, the effects of both programs are more accurately reflected in the rate-making process through appropriate billing units or the use of a future test year. AG/CUB Ex. 4.0 at 26. In fact, CUB notes, all parties besides ComEd who looked at this issue reached the same conclusion: There is no need to arbitrarily increase the ROE simply because the Company has chosen to avoid using more accurate mechanism to incorporate any impact that results from these programs. IIEC Ex. 1.0 at 54-55 and 4.0 at 22-24; Staff Ex. 5.0 at 55-58; Staff Ex. 23.0 at 4-9; Pre-Trial Memo of the Environmental Law and Policy Center at 1. CUB agrees with IIEC witness Mr. Gorman's statement that Dr. Tierney's proposal rewards ComEd for a risk that can be largely managed, "eroding the efficiency of the rate-setting process." IIEC Ex. 4.0 at 23-24. CUB also agrees with Staff that the Company is in effect seeking to manage potential sales volume losses in future years solely on the basis of one factor (i.e. energy efficiency) that might reduce future sales without any consideration of the many other factors that affect sales – including those which might increase sales. Staff Ex. 5.0 at 57-58.

2. Fixed Cost Recovery Adjustment

CUB recommends that the Commission adopt Staff's proposal that if the Commission authorizes ComEd to move toward a more fixed/variable rate design, as the Company proposes, the cost of common equity must correspondingly be adjusted for the resulting decreased risk. Staff Ex. 5.0 at 41-42. CUB agrees that the greater the extent to which the Company's fixed costs are recovered through a fixed charge, the lower the Company's operating risk will be. CUB supports Staff's recommendation of a 40 basis point (0.40%) reduction to ComEd's ROE if the Commission adopts an 80/20 fixed/variable rate design for ComEd. *Id.* Similarly, CUB supports Staff's recommendation of a 20 basis point reduction if the Commission alternatively adopts a 60/40 fixed/variable rate design for ComEd. *Id.* CUB explains that the Commission has consistently concluded that utility companies have a reduced risk of recovering their fixed costs, including their allowed revenue requirement, when the fixed portion of the customer charge is increased. Final Order, ICC 09-0306, April 29, 2010 at 217. ICC Docket 08-0363, Final Order at 71 (March 25, 2009). According to CUB, ComEd has given the Commission no reason to depart from this practice, and Staff's proposed adjustment here should be adopted.

G. Overall Cost of Capital (Derivative)

Using the capital structure and other information proposed by ComEd, the appropriate overall rate of return for the Company is 7.79%. AG/CUB Ex. 4.0 at 37. This reflects an 8.94% return on common equity is appropriate for ComEd and uses the capital structure and other information proposed by ComEd.

Weighted Average Cost of Capital

CAPITAL		AMOUNT	WEIGHT	COST	WEIGHTED COST
Long-Term Debt	$	4,772,707	52.56%	6.53%	3.43%
Short-Term Debt	$	9,736	0.11%	0.73%	0.001%
Common Equity	$	4,297,923	47.33%	8.94%	4.23%
Credit Facility Costs					0.12%
TOTAL	$	9,080,366			**7.79%**

All data but ROE from ComEd Ex 6.1 Schedule D-1

VIII. COST OF SERVICE AND ALLOCATION ISSUES

IX. RATE DESIGN

C. Potentially Contested Issues

CUB and the People, who are statutorily required to represent the interest of residential consumers in Illinois, strongly argue that ComEd's proposed rates do not meet the policy goals of fairness, equity, gradualism, and overall social welfare. CUB avers that in weighing the evidence presented against the uncontroverted policy goals of any rate design proposal, it is important to remember that the consumer parties have a unique expertise of evaluating the effect of rates on residential consumers and have a clear directive and responsibility to protect residential consumer interests.

CUB states that the rate design proposal recommended by AG/CUB witness Mr. Rubin allows ComEd to recovery its revenue requirement while simultaneously protecting both small and large residential customer interests. CUB maintains that ComEd's proposed rate design, in contrast, is primarily to insulate its revenue stream from variations in energy consumption and focuses solely on high-level cost causation principles that ignore the specific impacts on a large range of users in the residential class. See ComEd Ex. 14.0 at 34-35. CUB believes that ComEd's pledge to help low income customers, (ComEd Ex. 14.0 at 22), does not correct the significant inequities inherent in ComEd's proposed residential rates addressed by AG/CUB witness Rubin.

1. Straight Fixed Variable (ComEd Proposal)

CUB argues against ComEd's proposals to increase the fixed-cost portion of its recovery and to eliminate the distinctions based upon space heating, because they violates basic rate making principles of cost causation, efficiency, social welfare, fairness and equity. CUB maintains that ComEd's proposal ignores the inequitable and unfair customer impacts of its proposal, which would cause unreasonably large rate increases for the lowest users of energy in ComEd's territory. CUB states that ComEd's proposal improperly shifts substantial costs related to the use of electricity out of the energy-related charge and onto the fixed charge. CUB therefore urges the Commission to reject ComEd's proposed SFV rate design and its proposed elimination of two residential rate classes and instead adopt Mr. Rubin's recommended residential rate structure discussed herein.

AG/CUB witness Mr. Rubin examined ComEd's proposed residential rates and performed a detailed customer impacts analysis demonstrating the differences in usage characteristics within the residential class, as well as the different costs of serving each type of residential customer. Mr. Rubin asserts that ComEd's proposal to drastically increase its customer charge and reduce distribution (per KWH) charges bears no relationship to the reasons why various facilities are sized and installed on ComEd's system. AG/CUB Ex. 6.0 at 14-41; AG/CUB Ex. 11.0. CUB maintains that most importantly, electric distribution rates should reflect consumer demand for electricity, and not just the number of customers. Prices should send customers an appropriate price signal that increases in their energy demand result in increases in costs to the system, and reflect the fact that increased consumption results in increased costs to the system. To accommodate the principles of rate design and create rates that reasonably reflect the cost of servicing different types of residential customer, Mr. Rubin designed residential rates that maintain the Company's current four residential rate classes under both ComEd's proposed rates, as well as the revenue requirement recommended by AG/CUB in this docket.

ComEd witness Hemphill claims that because almost none of its distribution costs vary with energy consumption, most of its revenue should be recovered through fixed charges. *See* ComEd Ex. 46.0 at 9. CUB disagrees and states that ComEd's proposal only represents one aspect of the goals of rate design while other cost-causation realities, such as the variance of demand-related costs within the residential class, as well as principles of gradualism, fairness and equity in its analysis. Mr. Rubin found that the cost-of-service study ComEd produced in this case recognizes that there are substantial demand-related costs incurred to serve residential customers – a fact recognized by ComEd current residential rate design, but ignored by its proposed rate design in this proceeding. CUB avers that ComEd's pricing proposal treats residential demand-related costs as being related solely to the number of customers, not to those customers' demands for electricity. AG/CUB Ex. 11.0 at 2. Furthermore, CUB explains, ComEd's proposal to drastically increase its customer charge bears no relationship whatsoever to the reasons why various facilities are sized and installed on ComEd's system.

Mr. Rubin testifies that utilities make long-lived investments based on long-term projections of customer location, demand, and consumption. AG/CUB Ex. 11.0 at 3. He acknowledges that energy consumption facilities such as substations and transformers are based on ComEd's need to serve consumers' demands for electricity over the life of those facilities (which is measured in decades). *Id.* Therefore, Mr. Rubin finds that utility pricing must send customers an appropriate price signal that increases in their energy demand result in increases in costs to the system. *Id.* CUB maintains that ComEd's pricing proposal fails to do so.

Mr. Rubin's analysis showed that ComEd's proposal would result in some residential customers facing rate increases of 60%, 80%, or even 100%, even though overall rates would increase by about 20% under ComEd's proposed revenue requirement. AG/CUB Ex. 11.0 at 3. CUB contends that imposing increases on some customers of four or five times the average rate increase, for no other reason than to further the utility's notion of an appropriate cost-causation rate design policy or theory, is grossly inconsistent with the principle of gradualism. *Id.*

CUB explains that the essential way to evaluate whether a rate design proposal promotes equity is to compare the resulting revenues for each affected group of customers to the cost of serving those customers. Mr. Rubin testifies, "an equitable rate design will recover revenues in rough approximation to the cost of service." AG/CUB Ex. 6.0 at 22. CUB believes that the fairness of a proposed rate design within a rate class is most effectively evaluated through examination of a customer impact analysis, just as Mr. Rubin did in his direct testimony. Rather than review the rate impact on a "typical" or "average" customer, Mr. Rubin examined the effect on customers within the residential class over a wide range of usage characteristics, evaluating the extremes as well as customers with more typical usage patterns. AG/CUB Ex. 6.0 at 26. To conduct this analysis, Mr. Rubin used ComEd's actual billing data, which included customers who received 12 bills during 2009, or 2.9 million customers (out of 3.4 million total customers). *Id.* at 26. According to CUB, the People and Mr. Rubin, this data set is more than adequate to evaluate the fairness of ComEd's proposed residential rate design.

Mr. Rubin presented the findings of his customer-impact analysis in his direct testimony and in AG/CUB Ex. 6.08 (a distribution curve). AG/CUB Ex. 6.0 at 26-40. The results of his analysis demonstrate that there is a tremendous diversity among ComEd's residential customers, a diversity that is not properly addressed by ComEd's proposed residential rate structure. CUB notes that the data directly undercuts ComEd's rationale for placing most demand-related costs in the customer charge. Mr. Rubin explains that ComEd's proposal requires low-use customers to subsidize high-use customers within the same residential subclass because ComEd's rate design erroneously assumes that each customer within the residential class is responsible for the same level of demand. AG/CUB Ex. 6.0 at 31. For example, under ComEd's proposal, the lowest effective annual bill (that paid by fewer than 5% of customers) would be about \$300 per year. *Id.* Under present rates, the equivalent annual bill is less than \$200. *Id.*

Mr. Rubin's analysis demonstrates that ComEd's proposal would result in large percentage rate increases (in excess of 50% rate increases) for those who use the least amount of electricity (and, therefore, are least likely to cause ComEd to incur significant demand-related costs). *Id.* At the other end of the curve, Mr. Rubin explains that the two percent of customers with the highest bills currently (and, therefore, the greatest energy usage) actually would receive rate decreases under ComEd's proposal. *Id.* CUB maintains that it is grossly unfair to increase some customers' bills by more than 50%, yet others within the class – those imposing the largest costs on the distribution system - receive a rate reduction.

To correct the inequities inherent in ComEd's proposed residential rate design, Mr. Rubin proposes that ComEd's rates remain structured as they are currently exist, consisting of (1) customer charges that vary depending on whether the customer is in a single-family or multi-family building; (2) the same meter charge for all customers; and (3) a distribution charge that reflect each residential subclass' unique costs of service. AG/CUB Ex. 6.0 at 42-47. Mr. Rubin developed rates to satisfy an over-arching goal of recognizing the true cost of service, recovering the major categories of costs through charges that are related to the customer's use of facilities related to that cost category. *Id.* Gradualism and avoidance of rate shock are also key policy concerns addressed by Mr. Rubin's proposal. To achieve this end, he used a benchmark that no residential subclass should receive an increase more than 1.5 times the average increase for the whole residential class. Since ComEd has proposed an overall residential increase of 20.8%, Mr. Rubin's proposal ensures that no significant group of residential customers would receive more than a 31% increase under ComEd's proposed revenue requirement.

The specific rates Mr. Rubin recommends vary based on which revenue requirement is used. Mr. Rubin's recommended rates based on the Company's proposed revenue requirement is as follows:

Table 1: AG/CUB Proposed Rates Under ComEd's Proposed Revenue Requirement

	SF No Heat	SF Heat	MF No Heat	MF Heat
Customer	$9.50	$9.50	$7.30	$7.30
Meter	$3.18	$3.18	$3.18	$3.18
Distribution	2.915¢	1.872¢	2.653¢	1.583¢

AG/CUB Ex. 6.0 at 44. To ensure the fairness and equity of this recommendation, Mr. Rubin conducted a customer-impact analysis for each of the 2.9 million customers in ComEd's billing data set, and compared the bill to the bill under present rates. His analysis concluded that no customer would receive an increase of more than 28%. *Id.* at 44.

Mr. Rubin's proposed rate design, based on the AG/CUB recommendation for a rate decrease, is as follows:

Table 3: AG/CUB Proposed Rates

	SF No Heat	SF Heat	MF No Heat	MF Heat
Customer	$7.75	$7.75	$5.96	$5.96
Meter	$2.60	$2.60	$2.60	$2.60
Distribution	2.379¢	1.528¢	2.166¢	1.291¢

If the AG/CUB recommendations are adopted in their entirety, most residential customers would have the distribution portion of their electric bill stay about the same or reduced. CUB avers that these rates fairly apportion the cost of service among the diverse types of customers in the residential class and will greatly reduce the disparity between rates and the cost of service that exists under present rates. CUB argues that if the Commission authorizes a different revenue requirement than recommended by ComEd or AG/CUB, it should adopt the procedure outlined in Mr. Rubin's direct testimony at pages 48-50.

2. Decoupling (NRDC Proposal)

CUB opposes NRDC's decoupling proposal, which AG/CUB witness Mr. Brosch testifies has the effect of adjusting utility rates based solely upon changes in residential per-customer sales volumes without regard to other changes in the utility's rate base, operating expenses or cost of capital. AG/CUB Ex. 12.0 at 10-11. CUB maintains that NRDC's plan ignores the fact that utility expenses, rate base, and cost of capital are dynamic and shifts business risks associated with changes in sales volumes from the utility to utility customers. NRDC's request for baseline recovery on the allowed revenue requirement per customer represents single-issue ratemaking. CUB states that NRDC's proposal is technically deficient as well, as it does not include a proposed tariff, contains no supportive analysis or documentation and provides no evidence that the plan would lead to increased energy efficiency investments by ComEd.

Mr. Rubin also responds to the NRDC decoupling proposal, and concludes that it would protect ComEd's revenue stream at the expense of consumers, with no indication that such an extreme measure would result in any increased investment in energy efficiency. AG/CUB Ex. 11.0 at 19. He points out that decoupling should be rejected because: (1) it is inconsistent with sound regulatory policies that have been developed over many decades; (2) there is no evIdence ComEd would increase its investment in energy efficiency programs if decoupling was approved; and (3) there are better ways to promote energy efficiency investments. *Id.* at 15.

3. Class Definitions

CUB opposes ComEd's proposed restructuring of residential rates there is tremendous diversity among ComEd's residential customers. AG/CUB Ex. 6.0 at 28. CUB finds that the proposal to eliminate any distinction between heating and non-heating customers has a dramatic impact on heating customers. The cost to serve MF Heat customer is approximately $45.6 million, but under present rates those customers already are providing ComEd with $49.9 million in revenues. AG/CUB Ex. 6.0 at 23. ComEd's proposed rates would increase this even further to $54.7 million, even though those customers are already paying more than the cost to serve them. *Id.* According to Mr. Rubin, The effect would be that MF heating customers would pay nearly 20% more than the cost to serve them. *Id.* Similarly, SF Heat customers, who currently pay rates almost exactly equal to their cost of service, would receive a rate increase of approximately $3.0 million, which would exceed the cost of serving SF Heat customers by more than 14%. *Id.* Mr. Rubin's finds that if two heating subclasses are paying rates that exceed the cost of service by more than $12 million, the non-heating customers are the ones who benefit (*Id.*

at 24), a result which CUB finds is contrary to ComEd's claims that it is seeking to recover its costs from the cost-causers.

Mr. Rubin's analysis concluded that the present rates for heating customers are providing revenues in excess of ComEd's proposed cost of service for those classes. Mr. Rubin finds that Residential heating subclasses already are providing revenues in excess of the cost of service. The result, according to Mr. Rubin, is that costs are being over-recovered from heating customers and under-recovered from non-heating customers, resulting in inequitable rate design. CUB finds that this problem is exacerbated by ComEd's proposed elimination of heating sub-classes. CUB avers that ComEd's proposal would impose substantial rate increases on many heating customer, even though those customers already are paying rates in excess of the proposed cost of service. CUB recommends that the Commission should reject ComEd's proposal, and ComEd should retain the four existing residential subclasses (SF Heat, MF Heat, SF No Heat and MF No Heat) because of significant differences in the usage characteristics and cost of service each type of customer.

Mr. Rubin also identifies a problem with the Company's embedded cost of service study ("ECOSS") that causes an increase to residential customers' share of costs related to NCP demands when the residential class is broken up into four subclasses instead of two. This is because the ECOSS treats each residential subclass as a wholly separate customer class. AG/CUB Ex. 6.0 at 8. To correct for this anomaly, Mr. Rubin's analysis took the residential costs from ComEd's two-subclass study and reallocated them among the four residential subclasses. *Id.* at 10. This approach produces no effect any other rate classes. Mr. Rubin therefore recommends that the Commission direct ComEd in any future rate filing to allocate costs first to the residential class as a whole, then reallocate those residential costs among the residential subclasses.

Commission Analysis and Conclusions

In line with the principles of fairness, equity, gradualism and social welfare, we decline to adopt ComEd's SFV proposal or to eliminate the distinctions between space heating and non-space heating classes. As demonstrated by AG/CUB witness Mr. Rubin, eliminating the space heating distinction would result in gross subsidies within rate classes, and drastic rate increases for some residential customers but drastic decreases for others. As for ComEd's SFV proposal, we find that it does not acknowledges the relationship between customer demand and system costs, sending customers the wrong price signals with artificially low per-kWh charges. Mr. Rubin's analysis showed that demand-side costs are not related solely to the number of customers, but ComEd's proposal makes it seem so. ComEd proposal incorrectly ignores the fact that ComEd's investments in its system, how and why facilities are sized and installed on the system, relates more to customer use than solely the number of customers. Therefore, we adopt the recommendations of Mr. Rubin and decline to make the changes ComEd requests.

X. REVENUES

D. LATE PAYMENT CHARGE REVENUES

CUB's Position

CUB states that ComEd has improperly excluded $13.986 million of its 2009 test year recorded late fees as non-jurisdictional, because not all the late fees collected by ComEd have been recognized by FERC, the only other jurisdiction to which they could be claimed. AG/CUB Ex. 1.0 at 40-41. CUB avers that late fees collected from delivery service customers for not paying their delivery service bills must considered jurisdictional. ComEd argues that allocating all late fees as jurisdictional would result in a subsidy for RES customers (ComEd Ex. 30.0 at 21), but CUB maintains that ComEd does not adequately explain that assertion. To reflect the late payment charge reclassification to include all non-FERC late payment charges, CUB recommends an adjustment to revenues of $13,986,000. AG/CUB Ex. 7.1 Schedule C-14.

Commission Analysis and Conclusions

We find that the late fees collected by ComEd which the Company has classified as "non-jurisdictional" must be calculated in delivery services rates. ComEd must claim all of its revenues in one jurisdiction or the Company's revenue requirement is unfairly inflated. These fees are collected pursuant to delivery service tariffs from ComEd's delivery service customers. Therefore, we adopt Mr. Brosch's recommendation.

E. NEW BUSINESS REVENUE CREDIT

ComEd recommended an adjustment for its anticipated growth in customers during the pro forma period which would offset the cost of pro forma plant additions with the revenues it may receive from new customers during that same period. ComEd Ex. 30.0 at 21, ComEd Init. Br. at 159. No party disputed that ComEd should perform this calculation, which matches revenues from new customer growth with *pro forma* plant additions made to serve new customers. However, the Company also seeks to recognize a *pro forma* decline in customers. ComEd Init. Br. at 160. Mr. Effron explained that this was not appropriate, as the purpose of the credit was to offset plant additions for new customers—no plant additions are made because of customer decline. AG/Cub Ex. 8.0 at 160. Mr. Effron also recommended the same pro forma period as he demonstrated was appropriate for all other investments, through March 31, 2011 when actual investment can be trued up.

Commission Analysis and Conclusions

We adopt Mr. Effron's recommendation to adjust the new business revenue credit by only including new growth, and not calculating a decline in customers because the purpose of the credit is to offset plant additions that are made because of new customers. A decline in customers does not require plant additions to be made, and plant additions are the purpose of the new business credit.