STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

APPENDIX TO
ILLINOIS INDUSTRIAL ENERGY CONSUMERS
BRIEF ON EXCEPTIONS

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EXCEPTION 1 - Accumulated Depreciation/ADIT

III. Rate Base

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1. Post Test Year Adjustment

b. Accumulated Provisions for Depreciation

Commission Analysis and Conclusions

As many parties have pointed out, ComEd ignores the effect of the recent Appellate Court decision regarding ComEd's last rate case, *Commonwealth Edison Co, v. Illinois Commerce Comm.*, 405 Ill. App. 3d 389, 937 N.E.2d 685, 701-703 (2nd Dist. 2010). In that case, the Appellate Court specifically found that a utility's accumulated depreciation must match, in terms of the time period involved, its *pro forma* plant additions. It also made this ruling in the context of ComEd's last rate case. (*See, Commonwealth Edison Co,* 937 N.E.2d at 701-704). In so ruling, it reversed this Commission. We also note that it is not controverted that, if accumulated depreciation must match *pro forma* plant additions, ADIT must also correspond in this manner.

Merely filing a petition seeking leave to appeal to the Illinois Supreme Court has no effect on the Appellate decision. As such, we are required to follow it. We note that the Appellate decision in question is currently the law of the land. Also, there is no indication that ComEd sought a stay of this appellate decision. Further, we decline to ignore the Appellate Court decision until when the mandate issues. As the IIEC has alluded to, the appellate court mandate merely concerns what this Commission is required to do on remand, if anything. It does not concern the effect of the Appellate Court decision else wise. In the Appellate Court decision at issue, this Commission was reversed on a legal basis; the Appellate Court did not conclude further fact-finding on the part of the Commission is necessary. (*Id.* at 701-704). Therefore, when the mandate issues, is not relevant here.

We therefore find that ComEd shall adjust accumulated depreciation plant and ADIT in a manner that corresponds with the correct amount of *pro forma* plant additions that are previously set forth herein. The period of those post-test year plant additions is January 1, 2010 through June 30, 2011. ComEd shall also inform this Commission, and, all parties in this proceeding, as to any development in its Petition for Leave to Appeal to the Illinois Supreme Court, within three business days from the time when it receives notice regarding any decision or ruling made by the Illinois Supreme Court regarding ComEd's Petition for Leave to Appeal. We further caution all parties to refrain, in the future, from arguments that merely urge this Commission not to follow the law.

2. Accumulated Deferred Income Taxes (ADIT)

See Section IV C 1 b herein, entitled "Accumulated Provisions for Depreciation and Amortization-Related Provisions for Accumulated Depreciation."

EXCEPTION 2 - Cost of Common Equity

V. Rate of Return

E. Cost of Common Equity

Commission Analysis and Conclusion

ComEd, Staff, AG/CUB, and the IIEC have presented evidence supporting four different values for the cost of common equity. ComEd requests that the Commission approve its proposed total cost of common equity of 11.30%. ComEd Init. Br. at 89. This includes a 40 basis-point cost of equity adder adjustment to ComEd's base cost of equity. Tierney Dir., ComEd Ex. 13.0 at 3. Staff proposes a return on equity of 10.0 % (McNally Dir., Staff Ex. 5.0 at 33), IIEC proposes an estimate resulting in a 9.6% return on equity (Gorman Dir., IIEC Ex. 1.0 at 38) and AG/CUB proposes a return on equity of 8.94% (Thomas Dir., AG/CUB Ex. 4.0 Rev. at 37) with the possibility of an adjustment if SFV rate design is adopted (*id*. at 14-15).

ComEd's proposed base cost of equity is derived from the assessments performed by ComEd witnesses Dr. Hadaway and Dr. Seligson. Dr. Hadaway estimated ComEd's cost of equity using three basic discounted cash flow ("DCF") models and Dr. Seligson used a risk premium and a comparable earnings approach to determine the cost of common equity.

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

ComEd's witness Dr. Seligson used a risk premium and a comparable earnings approach to determine the cost of common equity. Dr. Seligson's quantification of ComEd's estimated ROE is flawed analysis. His numbers are inflated and even the Company is not recommending his final ROE. The only support Dr. Seligson supplied for the suggestion that the Commission should deviate from its consistent policy of rejecting the Comparable earnings approach is a survey of commissions conducted more than a decade ago, wherein only one-quarter of the one-half of commissions that responded used a comparable earnings approach, in some unspecified manner in their estimate of the cost of equity. Therefore, the Commission rejects the risk premium and comparable earnings ROE sponsored by Dr. Seligson.

We agree with ComEd that Mr. McNally's comparable company selections seemed to contain companies that are not that similar to ComEd. It was also noted that his multi-stage DCF analysis was incorrect because he uses a too low growth rate for GDP to average down his analysts' growth rate estimates. Mr. McNally improperly employs a "spot date" approach in his CAPM analysis as well as a "b times r" sustainable growth argument – both of which this Commission has recently rejected.

Also, as ComEd explains in its Initial Brief, Mr. McNally's CAPM analysis placed sole reliance on a risk free rate (30 year Treasury bonds) that he chose to measure on September 22, 2010. The Commission has recently rejected use of such a pure "spot date" approach in its *North Shore* decision (Thomas, Tr. at 1783) and noted the problems that can result from using such data. *Id*.; *See North Shore*

~~*Gas Co., et al*, ICC Docket Nos. 07-0241/07-0242 (Cons.), Final Order (Feb. 5, 2008) at 92, 125-6. Mr. McNally's choice of a September 22 spot date was unfair to ComEd because the 3.77% rate measured on that date is not only low, but is fully 67 basis points below the rate on December 29, 2010 and well below the risk-free rate investors demanded generally throughout the entire year. ComEd asserted that if Mr. McNally's CAPM were adjusted upward by those 67 basis points alone, the results of his CAPM model would have been 10.99%, not 10.32%. That result would, in turn, have significantly increased his total recommended cost of equity. *Id.*~~

~~The Commission finds that if Mr. McNally's CAPM were adjusted on an average of the 2 risk –free rates and closer to the average rate through out the year or half of the 67 basis points. The result of 33.5 points added to his CAPM model would be in the range of 10.50%. This number would be more in the range of Dr. Hadaway's midpoint of 10.6%.~~

~~The Commission finds problems with how Mr. McNally's GDP growth rate forecast is calculated because it is based on assumptions that are inconsistent with actual historical growth for the U.S. economy. For example, Mr. McNally's 2.4% inflation rate compares to historical GDP inflation rates that have averaged 3.5% and his real GDP growth rate of 2.5% is much lower than the actual historical growth rate of 3.4%. It is reasonable to believe that future real growth and inflation will both be 3% and therefore a 6% growth rate is a more reasonable proxy for investor's long-term expectations. Use of the 6% growth rate, combined with correction of Staff's comparable sample, increases Mr. McNally's multi-stage DCF results to 10.44% and an average DCF (non-constant and constant growth) of 10.29%. This is 60 basis points higher than the average of Mr. McNally's constant and non-constant growth DCF results.~~

~~A reasonable average between Mr. McNally' CAPM with adjustments and Dr. Hadaway's average is 10.50 %.~~

~~We find the testimony of IIEC and AG/CUB relating to ROE also unpersuasive. The evidence shows that Mr. Gorman's estimated ROE is too low because his model inputs are negatively biased and that under current market conditions his CAPM is unreasonable. In addition, we agree with ComEd that Mr. Gorman incorrectly believes that the cost of equity for utilities have declined as much as interest rates.~~

~~ComEd demonstrated that Mr. Thomas' estimated ROE is too low because he employs the discredited "b times r" internal growth rate in his constant growth DCF analysis and then combines the low growth rates with a too low 20-year historical average of GDP growth in his multistage model. The Commission has rejected this approach in the past and will not adopt this method in this proceeding.~~

~~In addition, like Mr. McNally, the Commission finds Mr. Thomas' improper employment of the "b times r" approach to support his contention that Dr. Hadaway's DCF growth rates are unsustainable to be unpersuasive.~~

~~Having reviewed all of the evidence and the arguments of the parties, the Commission finds that a 10.50% cost of common equity for ComEd is reasonable and is hereby adopted in this proceeding.~~

In this case, the Commission is presented with an unusually broad array of ROE estimation methodologies (DCF, CAPM, Risk Premium, and Comparable Earnings), ROE estimates (a range of 6.69% to 12.6%), market estimate modifications (three distinct adders or reducers) and recommended

returns (a range of 8.94% to 12.0%). ComEd alone has presented testimony from four or more witnesses who comment on various aspects of the utility's return on equity recommendation. In such circumstances, serious analysis of the estimates and recommendations on which the Commission will rely requires early identification of those that do not meet the standards established by the Commission.

The authors of the ROE analyses yielding the highest and the lowest recommendations used methodologies that the Commission has not favored in the past. At the high end is the Comparable Earnings estimate of ComEd witness Seligson. The Commission has regularly rejected Comparable Earnings analyses for more than a decade.[1] We do not find Selgison's conclusory statements about the methodology, or his exhibit presenting the book returns of an undefined collection of utilities, sufficient reason to change course in this case. The lowest estimate is a CAPM estimates from CUB-AG witness Thomas. In recent cases, the Commission has had an opportunity to consider the use of internal growth rates in DCF analyses. The Commission has found the methodology still novel and inconsistent with methodologies accepted by this and other Commissions. We decline to use either of these estimates here. Thus, the highest and lowest estimates ROE estimate will not be considered further.

The Commission has also declined to rely on Risk Premium (RP) estimates. In its April 29, 2010 Order, Docket No. 09-0306, et. al. (cons.) at 216), the Commission rejected the risk premium analysis. For that and other reasons summarized below, these estimates also will not be examined further or used in our analysis. Seligson's RP result was combined with his Comparable Earnings estimate to produce his recommendation. Thus, his recommendation lacks any basis on a methodology accepted by this Commission and will be excluded from our determination. ComEd witness Hadaway also used a RP analysis, his lowest estimate, but as that position was shared with a Hadaway DCF estimate, the exclusion of his RP estimate does not affect Hadaway's range of estimates. IIEC witness Gorman presented a RP analysis that was not used in determining his ROE recommendations. The remaining estimates are based on the DCF and CAPM analyses the Commission traditionally relies upon.

On this record, which details an economic environment affected by recent financial turmoil, all the experts conducting DCF analyses recognized the limitations of a constant growth assumption for the model. Each expert supplemented the constant growth model used in more stable times with multi-stage DCF models more attuned to less stable market environments. In multi-stage DCF analyses, the growth rate for the final period is key. Because the long-term growth rate in a DCF model persists for an infinite period, that input can have a decisive impact on the resulting ROE estimate. That DCF input must be sustainable over the long term. The experts all agree that current short-term analysts' growth rates may not reflect this long-term growth outlook. All ROE witnesses except the CUB/AG witness in this case used a GDP growth forecast as the long-term sustainable growth rate from use in a multi-growth stage DCF study. (Hadaway, ComEd Ex. 11.0 at 31; McNally, Staff Ex. 5.0 at 17; and Gorman, IIEC Ex. 1.0 at 25.

In reviewing the DCF estimates of ComEd, Staff, and IIEC, it is clear that the defining differences

[1] *See* Oct 22, 2003 Order, Docket No. 02-0798 at 88 ("the Commission does not believe it is appropriate to estimate CIPS' and UE's forward looking cost of common equity by looking to historical earned returns on common equity . . . ."); Nov 21, 2006 Order, Docket Nos. 06-0070-0072 (Cons.) At 141-2 concluding that the methodology "incorrectly assumes that earned returns on book common equity are the same as, or representative of, investor-required returns on common equity").

among them relate to their growth rate inputs. The growth rate divide in this case finds Hadaway on one side and every other ROE expert on the other. (IIEC Br. at 29, Chart). Hadaway uses a 6.0% GDP growth rate, while the other experts used GDP growth rates clustered within 18 basis points of 4.9%. Hadaway relies on growth rates he developed for this case, rather than long-term projections drawn from market sources like analysts' published long-term GDP growth rates, which are the basis for many market participants' expectations. Those published estimates indicate that investor expectations for GDP growth will be much lower than the GDP growth rate Hadaway used. As the trier of fact, we are also cautious about accepting outlier inputs that have been developed specifically for litigation, as are our courts when confronted with such evidence. The weight of the evidence is that the growth rates used by Staff and IIEC are reasonable, in the mainstream, and used by investors; Hadaway's are not. Accordingly, the Commission will consider the estimates produced by the DCF models with growth rate inputs shown to be reasonable by the record evidence -- those of Staff and IIEC.

The CAPM analyses of Staff and IIEC are generally unremarkable. Despite the Commission's past reliance on this methodology, no other party provided this ROE estimation analysis. Though the variance between Staff's DCF and CAPM estimates deprives the Staff recommendation of the added credibility that comes from mutually confirming estimates, we do not find it disqualifying. The Commission accepts both Staff's and IIEC's CAPM estimates for consideration.

Because the DCF and CAPM analyses and estimates of Staff and IIEC meet the Commission's traditional standards, we will use those parties' recommended return levels as the final inputs to our determination. We find that on this record, a reasonable return is in range defined by those IIEC and Staff recommendations – 9.6% to 10.0%. For reasons already discussed, the other ROE recommendations are not reliable and will not be used in our determination. Though superior to the other recommendations in this record, we must assess the relative strengths of these remaining two.

We have sometimes preferred analyses using a single day's data (like Staff's) over others using selected historical data periods (like IIEC's). However, it appears -- in retrospect – that there is some indication that the data used by Staff may reflect a short-lived market condition. (*see* ComEd Br. at 96-97) and that its developed market risk premium incorporated a high market return (*see* IIEC Br. at 31). In these circumstances, IIEC's period based estimate, which avoids some of the issues identified in Staff's estimate, merits increased weight. This Commission's reasoning in the similar circumstances of an earlier case is instructive.

> We note that the Commission has traditionally relied upon a single day's data in applying the DCF analysis, and we are very reluctant to deviate from Commission ratemaking practice. However, the whole point of conducting such analyses is to develop a proxy for the appropriate ROE. When it can be shown that the proxy itself strays from a zone of reasonableness to the degree where it offers an unreliable estimate of the appropriate ROE, as the Utilities have demonstrated with Staff's DCF analysis in this case, deviation from accepted practice may be warranted. (Feb 5, 2008 Order, Docket No. 07-0241 at 92).

While we do not view the result of Staff's analysis as unreliable, we do find that it should not be the only basis of our determination. In addition, as IIEC's analysis avoids the identified difficulties of Staff's, we will give it equal weight. The result of that averaging of Staff's and IIEC's return on equity

recommendations is 9.8%, which we find to be reasonable under the market conditions described in the record and reflected in these estimates.

EXCEPTION 3 - Allocation of the Illinois Electric Distribution Tax
And
EXCEPTION 4 - Collection of IEDT

VI. Cost of Service and Allocation Issues

C. Potential Contested Issues

1. Embedded Cost of Service Study Issues

I. Allocation of Illinois Electric Distribution Tax

Allocation of the Illinois Electric Distribution Tax is addressed in Section VII..C.4. of this Order entitled Collection of Illinois Distribution Tax

~~**VIII. THE COMMISSION SHOULD NOT DEFER A DECISION ON DECOUPLING**~~

~~**F. Decoupling Will Have a Positive Impact on Energy Efficiency in the ComEd Service Territory.**~~

~~**3. Collection of Illinois Electricity Distribution Tax**~~

~~**a. Reasonableness of Current Allocation**~~

~~**b. IIEC Recommended Allocation**~~

VII. Rate Design

C. Potentially Contested Issues

4. Collection of Illinois Distribution Tax

a. Reasonableness of Current Allocation

b. IIEC Recommended Allocation

Commission Analysis and Conclusion

~~In the Ameren rate cases, the Commission reviewed the legislative history of the Public Utilities Revenue Act ("PURA") and determined that the General Assembly intended "to replace the invested capital/plant in service tax with a kWh tax in response to the changing nature of the Illinois electric utility industry." Ameren Order at 243. The legislature was anticipating that vertically integrated utilities like ComEd and Ameren might shed their generation assets (a significant part of plant in service), an event that has, in fact, occurred.~~

~~We agree with Staff that since the IEDT is related to usage, cost causation principles would argue~~

~~for recovery through a per-kWh charge from all customers. The proposed change would have no impact upon residential, watt-hour and lighting customers because costs associated with the Illinois Electricity Distribution Tax are already recovered through per kWh DFCs for these customers. This is not a tax imposed on customers but rather is directly imposed on ComEd, Therefore, Section 70 ILCS 3605 does not apply to the IEDT tax imposed on ComEd and we find that the CTA is responsible for this tax.~~

~~In light of our prior treatment of the Illinois Electricity Distribution Tax in the Ameren Order, the Commission adopts ComEd's proposal to modify its rate design to provide a separate volumetric charge for the recovery of the Illinois Electricity Distribution Tax and uncollectible costs associated with the application of the tax for all of the reasons stated herein.~~

I. Allocation

To begin, we note that we first approved an energy allocator for what is being called the IEDT in the first ComEd delivery service case, Docket No. 99-0117. At approximately the same time, we approved plant in service allocators for each of the other electric utilities (several of which are now a part of Ameren Illinois utilities). In reviewing our intervening ComEd delivery service rate case orders, in Docket Nos. 01-0423, 05-0597 and 07-0566, we find no subsequent analysis of this issue. Thus, ComEd has allocated this tax on an energy basis since 1999. But there has been an inconsistent policy on this matter among the utilities for several years. We also note that in 2010, we reversed course on this matter at the request of the Ameren Illinois utilities and approved an energy allocator for those utilities as well. Thus, even if we see merit to IIEC's proposal, approving IIEC's proposal in this case effectively would be a reversal of our 1999 decision for ComEd and, as pointed out by Staff, would differ from our more recent decision in Docket No. 09-0306, et. al. (cons.). Consistent policies are to be preferred only when they are sound. Accordingly, we will carefully review the record, the cirumstances of our past decisions, and any relevant similarities or distinctions.

In Docket No. 99-0117, the Commission established the first-ever unbundled delivery service rates for Illinois utilities, along with implementation plans to establish a competitive electric retail supply market. In 1999, of necessity we decided a large number of novel issues in a relatively short amount of time. As our knowledge of delivery services and competitive market practices has increased, we have revised or refined our positions on a large number of issues. For example, we have approved changes to ComEd's delivery service rate structures in virtually every delivery service rate case since 1999. Also, we have changed allocation approaches on several cost of service items, including the primary versus secondary facilities and the CP vs. NCP issues being addressed in this case. In Docket No. 09-0306, et. al. (cons.), we reversed our long-standing position for the Ameren Companies on the very issue of the subject tax, which was referred to as the PURA tax in that case. The upshot is that we are not bound to forever follow prior decisions, if the information presented warrants a change.

There is a superficial, appeal in rejecting IIEC's proposal on the basis of the recent uniformity in allocation practices based on the formula in the PURA tax statute. As all parties acknowledge, the current law uses tiered per kWh rates to compute the utility's tax liability. However, as IIEC argues, calculation of the tax is not necessarily the same as cost causation for the Commission's rate setting purposes.

The unrebutted evidence in this case is that the tax rates in the PURA law were designed to collect the same level of tax utilities paid in 1997, with allowances for growth in tax collections, limited by the

increase in CPI or 5%. Thus, there is forever a link to the 1997 tax levels, which were based on utility plant in service. However, it is also clear that there is a link to kWh sales, since a utility's tax obligation in any year is affected by its level of sales, especially in years when the statewide cap is not exceeded, (should that occur). There is a similar link to its level of tax payments relative to other utilities, in years when the cap is exceeded (which the evidence shows occurs regularly).

Staff argues that current changes in plant in service do not affect tax liability. While true, this is not dispositive. As IIEC has pointed out, changes in kWh sales do not necessarily affect tax liability either, particularly in years when the statewide cap is exceeded, as it regularly has been. Plus, as mentioned, there is no denying the link to 1997 plant in service in determination of the tax rates, which in turn, has a large impact on the tax liability today.

Based on the record evidence in this case, neither an allocator based fully on plant in service, nor one based fully on kWh sales, adequately reflects cost causation for the IEDT. This record presents a full factual examination of the sources of the IEDT expense ComEd incurs that was not available to the Commission previously. That record shows, despite our prior determinations, both distant and recent, that allocators based fully on plant in service or fully on energy deliveries should not be used. IIEC's proposal in this case, which is different from the proposal examined in Docket No. 09-0306, et. al. (cons.) (which we did not adopt), is the only position in the record in this case that recognizes the dual causative nature of both plant in service and energy. Accordingly, we approve IIEC's approach. Allocation of IEDT expense based on cost causation requires us to segregate the IEDT into two parts. The 1997 level of IEDT, *viz* $99.5 million, will be allocated on the basis of utility plant in service, which is best represented by classes' shares of plant in service today. The amount above the 1997 level will be allocated on the basis of energy delivered, as measured by kWh delivered. With a fixed 1997 level of IEDT, the proportion that is allocated on energy will grow over time, as ComEd's total tax liability grows.

This decision differs from our recent decision in Docket No. 09-0306, et. al. (cons.), involving the Ameren Utilities. There are evidentiary distinctions between this record and the evidence in that docket. There the record presented two fully developed alternatives: Ameren's position, allocation fully on energy delivered or IIEC's proposal for allocation fully on plant in service. (Order, Docket No. 09-0306, et. al. (cons.) at 243: "AIU, Staff, and IIEC each make compelling arguments for and against allocating the PURA tax on the basis of either plant in service or kWh"). IIEC's alternative approach in that case, which was similar to the approach we find appropriate in this case, was introduced in rebuttal testimony and was not fully developed.

There are also legal issues that impel a different result. We find that the neither the purpose nor the language of the tax statute at issue evinces a legislative intent to intrude on the exclusive ratemaking authority of the Commission by altering the Commission's policy on tax expense allocations for rate setting purposes. Consequently, our determinations are governed by the PUA. We are compelled by our enabling act to base rate setting decisions on the evidence of record before us. As discussed above, this record shows an undeniable causal connection between allocated expense and the allocation bases we approve. Our consistent policy of allocating costs on the basis of cost causation requires use of those allocation factors.

Based on evidence of record, IIEC has best identified cost causation and has identified the appropriate allocation method for the distinctive portions of the IEDT expense. Accordingly, we adopt IIEC's approach for use in the approved cost of service study in this case.

ii. Collection

We agree with IIEC that ComEd has provided no compelling reason to change the collection mechanism for this ComEd expense element. As pointed out previously, ComEd has allocated the IEDT cost to classes using an energy allocator since 1999, but has recovered this cost, like most of its other expenses, through its existing DFC charges. We see no reason to change the collection process at this time irrespective of the allocation method approved.

This conclusion is especially apt because of the change in allocation method adopted in this order, whereby, much of the IEDT cost will be allocated to customer classes on the basis of plant in service, rather than kWh. Costs related to plant in service are collected from customers through the DFCs. A change to a separate energy-based charge becomes less logical in these circumstances.

EXCEPTION 5 - Primary/Secondary Split

VI. Cost of Service and Allocation Issues

B. Potentially Contested Issues

1. Embedded cost of Service Study Issues

b. Primary/Secondary Split

(i) The Appropriate Methodology/Non-Conformance with What the Commission Required in its final Order in Docket 08-0532

(ii) Functional Identification of Costs

Commission Analysis and Conclusion

~~Nothing in the *Rate Design Investigation* Order required ComEd to do what the IIEC argues. The IIEC asserts that single-phase primary circuit costs and line transformer costs should be reallocated. However, the Commission did not address this issue in the *Rate Design Investigation* Order. Additionally, while the IIEC has presented its arguments in detail, it has not proffered any evidence to indicate that Staff is incorrect when opining that serving primary voltage customers on a circuit may require ComEd to incur the additional cost of a three-phase line, while a single-phase line could serve secondary loads.~~

~~The IIEC has also not presented facts disputing Staff's conclusion that the IIEC's arguments on this issue are one-sided, as, serving primary voltage customers on a circuit may require ComEd to incur the cost of a three-phase line, while, a single-phase line might be sufficient to serve secondary loads. Because, at this time, these costs do not appear to be as neatly (and fairly) segregable as the IIEC asserts, we further conclude that, at this time, ComEd's Primary/Secondary split analysis did not violate the *Rate Design Investigation* Order on this issue. We therefore conclude that, on an evidentiary basis, the IIEC's arguments fail here.~~

It is clear from the evidence presented by ComEd and IIEC that ComEd's proposed cost of service study does not allocate the costs of line transformers exclusively to secondary voltage customers, despite our conclusion and direction in Docket No. 08-0532. Since the function of these facilities (which transform electricity to secondary voltages) is to serve customers taking service at secondary voltage, their cost is appropriately allocated to secondary customers only. This function, not the fact that the energized voltage of the transformers may be at a primary voltage, should determine the responsibility for their costs. This conclusion is consistent with our findings and conclusions in Docket No. 08-0532.

Accordingly, ComEd's proposed cost of service study, as presented in ComEd Ex. 75.1, cannot be approved. We note that this outcome is consistent with our earlier rejection of ComEd's proposed rate structure, as the structure of ComEd's cost of service study and the rate design are tied to each other.

Our rejection of ComEd's misallocation of line transformers does not affect ComEd's Preferred Exemplar (ComEd Ex. 75.2) or Alternative Exemplar (ComEd Ex. 75.3) cost of service studies, since these studies are understood to comply with our directive respecting line transformers.

We have reviewed ComEd's treatment of single-phase primary line costs against our direction to ComEd in Docket No. 08-0532 to develop and provide in its next rate proceeding: "... (3) function based definitions of service voltages for facilities other than the line transformers already addressed." This direction meant, and continues to mean, that ComEd should determine the function of its facilities in providing service and which customers certain facilities serve, especially whether primary or secondary voltage customers, instead of the energized voltage of the facilities themselves. This is what we found for line transformers in Docket No. 08-0532, and reiterated in this case. No other interpretation of our direction in Docket No. 08-0532 is reasonable, particularly in view of our specific instruction for the treatment of line transformers.

We are persuaded by the evidence in this record that single-phase primary facilities function almost exclusively, to serve secondary customers. Indeed, we find no credible argument to the contrary in any of the parties' testimony. Therefore, the costs of such facilities, as determined by the IIEC cost of service study, should be allocated to secondary voltage customers only. No other party provided a determination of these single-phase primary facilities costs. The fact that a very small fraction of ComEd's single-phase primary lines may be used to serve 8 customers on ComEd's system (of nearly 4 million customers) does not require a fractional allocation in this analysis.

Although Staff acknowledges that single-phase primary facilities serve secondary customers, it recommends denial of IIEC's allocation based on its proposition that primary customers may require three-phase facilities that cause incremental costs that should not be borne by secondary customers. This raises an interesting question, but Staff has not identified any categories of three-phase facilities that exist solely to serve customers at primary voltages. Furthermore, part of the premise of Staff's position appears to be that only primary voltage customers are served by three-phase lines. However, the record evidence shows that not only are secondary voltage customers served by three-phase lines, ComEd would use three-phase lines for its distribution system even if all of its customers were secondary voltage customers. Under the circumstances, we cannot conclude that there is a major cost allocation issue here that would warrant any delay in properly allocating the cost of single-phase primary lines (used to serve only secondary customers) in this case. Moreover, Staff raised its hypothesis in rebuttal testimony, which did not allow for parties other than ComEd to respond. One result is that the record lacks actual evidence of such facilities, let alone any quantification of the costs that may be at issue. As a result, we are unable to determine whether, or how much. such facilities' cost might offset the allocation of single-phase facilities costs to secondary customers. We cannot conclude that there would be a one-for-one offset, which would be the practical effect of Staff's recommendation to deny the single-phase adjustment proffered by IIEC. Staff and interested parties may explore this issue of quantifying three-phase facility costs that should be allocated exclusively to primary customers further in the next rate case, should they desire.

~~However, as shall be explained below, w~~We do concur with the IIEC's argument that ComEd, generally, has not complied with the Commission's Order in the *Rate Design Investigation* Order in docket 08-0532. We further note that once ComEd finally complies with the requirements in that Order, further segmentation of ComEd's costs may be necessary, depending upon the outcome. REACT's

argument is addressed elsewhere herein, in the Section entitled “Investigation of Assets used to Serve Extra Large Load Customers.”

EXCEPTION 6 - NCP vs. CP Allocator

VI. Cost of Service and Allocation Issues

C. Potentially Contested Issues

1. Embedded Cost of Service Study Issues

d. NCP (Non-coincident Peak) v. CP (Coincident Peak)

Commission Analysis and Conclusions

~~In the *Rate Design Investigation* docket, docket 08-0532, Final Order of April 22, 2010, at 55; the Commission specifically addressed this issue in relation to the arguments of ComEd, the IIEC and others. This issue was thoroughly explored therein. In that Order, this Commission concluded that CP is the correct factor to use. (*See also*, *In re Central Illinois Light Company*, docket 09-0306, Final Order of April 29, 2010, at 237). We therefore decline to deviate from these past decisions. We additionally note that essentially, the IIEC and the Commercial Group maintain that these previous decisions were erroneous because the costs that are allocated should mirror engineering concerns for NCP. However, there is no credible evidence that the investments in question, distribution substations and primary lines, correlate to NCP-related investments.~~

~~This is true because that there is no indication from the evidence presented here, that NCP, which is a form of "worst case scenario" on a system-wide basis would fairly allocate the costs involved in calculating NCP amongst the customer classes. Generally, what is involved in a "worst case scenario" for an industrial area will be far different from that which is involved in a residential area. It therefore appears that, based on the evidence presented, imposition of NCP costs on this basis could raise the cost of electricity to lower-using customers, (*e.g.*, residences) even though these lower-using customers did not cause much of the NCP-related costs on an overall basis, or to higher (*e.g.*, industrial) users. This is inapposite to the notion of attributing cost-causation to those who incur the costs in questions.~~

~~Finally, we find the IIEC's dismissal of Dr. Hemphill's testimony, on the basis that he is not an electrical engineer, not to be persuasive. This issue concerns cost allocation. The IIEC has made no showing establishing that Dr. Hemphill is unqualified to testify regarding cost allocations.~~

As a preliminary matter, we acknowledge that ComEd's cost of service study has traditionally used the NCP allocator for primary lines and substations and that our decision in Docket No. 08-0532 compelled ComEd to file its cost of service study in this case using a CP allocator. ComEd has complied with our directive. However, in reaching our decision in Docket No. 08-0532, we did not state that we would not consider further evidence on this matter in subsequent rate cases, including this one. Indeed, while our conclusion in Docket No. 08-0532 was supported by substantial evidence in that case, it is clear that the issue was not fully developed in the case, as compared to the evidence adduced in the case at bar. We would not be prohibited from finding in this case that either a CP or NCP allocator is appropriate, based on the evidence. We note that, since we did not modify rates in Docket No. 08-0532, ComEd's delivery rates to date have not been based on a cost of service study utilizing a CP allocator for primary lines and substations.

The evidence of ComEd and intervenor engineers about distribution system planning is persuasive. According to these witnesses, the local distribution systems, i.e. the circuits in various parts of ComEd's territory must be sized to adequately handle the maximum demands on those particular circuits, no matter when they occur. For some circuits, this presumably would be at the time of ComEd's system peak, for others such may not be the case. In any event, since the systems are sized to meet the localized peaks, as opposed to the overall ComEd system peak (which is measured as CP), we must determine which allocation approach best reflects the contribution of customers to localized peaks.

The evidence is clear that all customer classes contribute to some degree, to the localized, or circuit peaks. Both the CP and NCP allocators take into account a proportion of all classes' loads. However, a CP allocator assigns virtually no cost responsibility to off-peak loads, such as lighting. This would be true even if a circuit was built exclusively to serve off-peak loads, since the CP of such a class would be minimal. If classes with significant off-peak loads utilize the primary circuits, which they do, and can affect local circuit design capacity, since localized facilities are sized to meet circuit maximum load, it is reasonable that they should be allocated a reasonable share of primary circuit costs.

Having considered the technical evidence of the parties in this case, along with the evidence about industry practice and the clear language of the NARUC Electric Utility Cost Allocation Manual, we are persuaded that the NCP allocator better reflects cost causation of the primary distribution system than does the CP allocator. ComEd is directed to modify its cost of service study to utilize such allocators.

That this conclusion is a reversal of our prior decision in Docket No. 08-0532 is not of particular concern, as the evidence is different, and generally more conclusive, in this case. Further, as noted above, approving the use of NCP allocator in this case has the practical effect of simply maintaining the allocator traditionally used by ComEd. As Staff and others point out, we approved the use of a CP allocator in the recent Ameren rate cases as well, Docket No. 09-0306, et. al. (cons). Our decision in those cases was based on the record adduced therein. It is not in any way controlling in this case, which involves a different evidentiary record.

EXCEPTION 7 - Rate Moderation

VI. Cost of Service and Allocation Issues

D. Rate Moderation

~~See Section VIII C. 4. a. of this Order, entitled "Movement Toward ECOSS."~~

IIEC's Position

In this case, IIEC has proposed a rate moderation plan similar to the one approved in the recent Ameren rate cases, Docket No. 09-0306, et. al. (cons.). Specifically, IIEC proposes that the increase to any delivery service rate class or subclass be limited to 150% of the overall revenue increase, inclusive of the impact of the IEDT approved for ComEd.

According to IIEC, rate moderation and avoidance of rate shock is an important principle of proper utility rate design. The Commission has recognized the importance of that principle in its recent decisions in the Docket No. 09-0306 et al. (cons.), and in the last ComEd rate case, Docket No. 07-0566. In the Docket No. 09-0306, et. al. (cons.), the Commission stated:

> [M]itigation strategies serve an important role in promoting rate continuity and rate stability while considering potential bill impacts that could result as rates are moved toward the actual cost of service.
>
> * * *
>
> It is a widely held ratemaking policy that rates should be designed to reflect cost causation, maintain gradualism, and avoid rate shock. (Docket No. 09-0306, et. al. (cons.), Final Order, April 29, 2010 at 287, 295).

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

> Therefore, we accept ComEd's ECOSS with the following modification. Above, we determined that the proper assignment of primary and secondary distribution costs would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage, and Railroad delivery classes. It would be inconsistent with that finding to accept ComEd's two-step rate increase. Instead, an allocation that more closely reflects a proper cost of service would be reflected in a four-step, gradual movement toward rates based on the ECOSS for Extra Large Load, High

> Voltage, and Railroad Delivery Classes. ComEd Ex 30.0 at 43-45. Thus, the Commission authorizes a 25% movement toward ECOSS based rates for these customers, instead of a 50% movement.
> (*Id*.).

The second way the Commission recognized the need for rate moderation, according to IIEC, was in our use of percentage deviations from the system average increase as a measure of rate impact. IIEC claims that, in our discussion of the Railroad Class, the Commission essentially defines rate shock in terms of increases in multiples of the ComEd system average increase.

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

IIEC states that these recent decisions show that the Commission, 1) recognizes the importance of rate moderation and avoidance of rate shock, and 2) uses percent of overall increase as an indicator of rate shock. In Docket No. 09-0306, et. al. (cons.), the Commission limited the increase for any class to 150% of (1.5 times) the utility average increase, as proposed by Staff and IIEC, including the impact of the Public Utilities Revenue Act (PURA) tax (referred to as IEDT in this case). IIEC points out that we also agreed with IIEC's specific recommendation to apply rate moderation at the subclass level, since customer impacts are more related to subclass changes more than to full rate class changes.

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

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

In the current case, IIEC claims that it is the only party that has addressed rate moderation in a manner consistent with the Commission's recent determinations. According to IIEC, ComEd only proposed gradual movement toward cost of service, without regard to the specific bill impact. Staff, on the other hand, ignores altogether the issue of rate moderation in this case, despite its proposal for (and Commission approval of) rate moderation in Docket No. 09-0306, et. al. (cons.). Staff's focus appeared to IIEC to be exclusively on movement toward cost of service, without regard to rate moderation or avoidance of rate shock for any class.

IIEC states that its witness Stephens took account of the Commission's policies and referencing the ELL, High Voltage ("HV") and Railroad delivery classes, pointed out that it is important that protections be put in place to ensure that undue rate impacts are avoided with respect to all rate classes, not just three. Accordingly, and consistent with the Commission's recent decision involving the Ameren Illinois Utilities, Docket No. 09-0306, et. al. (cons.), he recommended that the Commission approve a rate moderation plan whereby no customer class or sub-class experiences an increase in delivery charges of more than 150% of the overall ComEd revenue increase, inclusive of the impact of the Illinois Electricity Distribution Tax. For example, should the Commission approve a 20% increase in ComEd's delivery revenues in this case, no class or sub-class should receive an increase greater than 30% (20% x 1.50).

IIEC states that our four-step movement toward cost of service for the ELL, HV and Railroad classes, discussed in Section VIII.C.4.a. below, alone is insufficient protection against rate shock. Further, it applies only to three ComEd rate classes. IIEC proposes that the Commission should recognize the importance of the policy of rate moderation, without regard to which customer classes may need the protection, as we did in Docket No. 09-0306, et. al. (cons.). Customer classes that experience unduly large delivery service increases, i.e. more than 150% of the overall ComEd increase, should receive protection, regardless of the identity of the particular rate class. IIEC claims, however, that ComEd, like some other parties, ignores the overarching principle of rate moderation, and focuses exclusively on movement toward cost based rates as though less than full movement to cost guarantees avoidance of rate shock. Indeed, ComEd essentially equates avoiding rate shock with only moving partially toward cost, despite the Commission's two most recent rate decisions that have not accepted that equivalency, according to IIEC.

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

IIEC asserts that implementation of its rate moderation plan will be relatively straightforward, as it was Docket No. 09-0306, et. al. (cons.). Mr. Stephens explained the approach for determining the applicability to classes and subclasses, once the decisions about revenue allocations are known, and the necessary spreading of cost recovery among customer classes, if needed. IIEC goes on to state that, consistent with its orders in Docket No. 09-0306, et. al. (cons.) and the ComEd rate case in Docket 07-0566, the Commission should recognize the need for rate moderation and avoidance of rate shock, and should approve the rate moderation plan proposed by IIEC in this case, as outlined above and in the testimony of IIEC witness Stephens.

Commission Analysis and Conclusion

The Commission is acutely aware of the need to moderate rate impacts and to promote gradualism and to avoid rate shock. We most recently acknowledged this in the recent Ameren rate cases, Docket No. 09-0306, et. al. (cons.), but also regularly acknowledge it in ComEd and other rate cases. While we are not bound to a specific rate moderation approach, we see no reason to deviate from the protections we recently approved in the Ameren cases, Docket No. 09-0306, et. al. (cons.). Specifically, and consistent

with IIEC's position in this case, we find that the increase to any delivery service rate class or subclass revenues should be limited to 150% of ComEd's overall revenue increase, inclusive of the impact of the IEDT approved. As IIEC points out, this protection ultimately may not affect any class' or subclass' charges. This would be a positive result, meaning our other decisions about revenue requirement, cost of service, rate design etc. are not leading to rate shock. However, if they should, it is important to maintain this overarching protection, which allows rates of classes that are below cost to move closer to cost of service, while protecting all classes against rate shock. Thus, unlike in Docket No. 07-0566, where we rejected an across the board increase because it interfered greatly with movement toward cost, we do not find that our Ameren approach, as proposed by IIEC here, to constrain movement to the same degree.

EXCEPTION 8 - New Primary Voltage Class v. Primary Subclass Charges

~~**VIII. THE COMMISSION SHOULD NOT DEFER A DECISION ON DECOUPLING**~~

~~**F. Decoupling Will Have a Positive Impact on Energy Efficiency in the ComEd Service Territory.**~~

~~**1. Class Definitions**~~

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

VII. RATE DESIGN

C. Potential Contested Issues

2. Class Definition

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

Commission Analysis and Conclusions

ComEd has not made a sufficient showing that the primary voltage customers that it proposes to remove from existing rate classes and ~~that it proposes~~ to consolidate into a single Primary Voltage delivery class~~es which are, the Small Load, Medium Load, Large Load, Very Large Load and Extra Large Load~~ have the same characteristics, justifying making one rate class for all of these very different customers. While ComEd witness Mr. Alongi testified that all of the primary voltage customers are provided with the same facilities, regardless of voltage, he testified that the *on property* facilities are identical. (ComEd Ex. 73.0 at 25-6). He did not state that the cost of providing services to these classes is the same. Conversely, he did not explain how the facilities used to serve customers at secondary voltage differ in a way that warrants size differentiation, while the facilities used to serve primary customers do not. In fact, based upon the evidence presented, it appears that ComEd's ~~proposed rate design (ComEd Ex. 73.1) and its~~ Exemplar Rate Design (ComEd Ex. 73.2) attempts to group customers with usage patterns that differ, widely, and that have very different usage patterns. We therefore decline to consolidate the primary voltage customers from the Small Load, Medium Load, Large Load, Very Large Load and Extra Large Load delivery classes into one class, per the Exemplar Rate Design approach, and reject ComEd's proposed rate design, which maintains lack of voltage differentiation within these classed in existing rates.

It also appears that Mr. Alongi's testimony justifying the consolidation of these classes mentioned only a small range of physical customer costs and not all of the costs involved in providing service to these customers. Additionally, as the IIEC points out, ComEd's preferred rate design (ComEd Ex. 73.1) does not differentiate between primary and secondary ~~customer~~ delivery costs. Also, ComEd's Exemplar Rate design (ComEd Ex. 73.2) appears to impose DFC charges on the secondary classes that are not explained.

Having so concluded, we note that ComEd's Alternative Exemplar Rate Design, that which is reflected in its Exs. 73.3 ~~75.3~~, and substantiated with its embedded cost of service study in ComEd, 75.3 ~~73.3~~, ~~is the only embedded cost of service study that~~ comports with the final Order in docket 08-0532, ~~as it is the only study~~ in that it divides primary non-residential customers into the same size categories as those for secondary customers and breaks down demand-based DFC charges based on primary/secondary considerations. ~~Therefore, this is the only cost of service study that we will consider.~~ We acknowledge, however, that ComEd's Alternative Exemplar ECOSS does not conform in other ways with the Investigation of Rate Design Order. (*See,* the Section herein entitled "Compliance with Docket No. 08-0532.").

We further adopt the IIEC's further-refined ECOSS as the applicable cost of service study to use here, as it also ~~further~~ differentiates the DFC based upon primary/secondary considerations, but does not introduce new charges for transformers. We note that no party has asserted that the IIEC's ECOSS is not accurate or is otherwise deficient in this regard.

EXCEPTION 9

~~**VIII. THE COMMISSION SHOULD NOT DEFER A DECISION ON DECOUPLING**~~

~~**F. Decoupling Will Have a Positive Impact on Energy Efficiency in the ComEd Service Territory.**~~

~~**2. Non-Residential**~~

~~**a. Movement Toward ECOSS Rates**~~

~~**(i) Extra Large Load, High Voltage Customer Classes**~~

VII. RATE DESIGN

C. Potentially Contested Issues

3. Non-Residential

a. Movement Toward ECOSS Rates

I. Extra Large Load and High Voltage Customer Classes

Commission Analysis and Conclusions

We decline to implement a rate design that moves these two classes more than what ComEd has proposed to do. While we appreciate that Staff's proposal moves these classes closer to actual cost, Staff's proposal is not consistent with the principle of gradualism, which avoids rate shock. ~~We also acknowledge that ComEd's rate design focuses on the DFC charge for these classes, which is "putting the cart before the horse," as the rates design here determined the revenue allocation, instead of having the cost of service determine the revenue allocation.~~ However, we note that it appears that this was the case in ComEd's last rate case, where the model was created to have 25% increases toward cost of service for these two classes. We decline to alter that model at this time. We therefore decline to adopt Staff's proposal. We also decline to impose the caps that the IIEC proffers for rate increases. If limits are placed on some rate classes, other rate classes would be "making up the difference." We therefore approve ComEd's rate design.

In so ruling, we acknowledge, as REACT points out, that this movement toward ECOSS-based rates is, in fact, based upon faulty ECOSS studies. However the study approved herein is greatly-improved over what has been previously submitted in other dockets. And, rulings made herein have improved its accuracy. While the ECOSS approved here still needs further refinement, which shall take place in a future rate case, it is accurate enough to move, gradually, toward cost-based rates for these two classes.