STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	)	
	)	**Docket No. 11-0721**
	)	
Proposed general increase in electric rates filed pursuant to Public Act 97-0616 (tariffs filed Nov. 8, 2011)	)	

DIRECT TESTIMONY OF RALPH C. SMITH

ON BEHALF OF

THE CITIZENS UTILITIES BOARD

CUB Exhibit 1.0

January 13, 2012

Revised February 24, 2012

OFFICIAL FILE
I.C.C. DOCKET NO. 11-0721
CUB Exhibit No. 1
Witness Ralph Smith
Date 3/12/12 Reporter TD

Date Reporter
Witness
Exhibit No.
I.C.C. DOCKET NO.
OFFICIAL FILE

COMMONWEALTH EDISON COMPANY
DOCKET NO. 11-0721
TESTIMONY OF RALPH C. SMITH
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I. INTRODUCTION

Q. Please state your name and business address.

A. Ralph C. Smith, 15728 Farmington Road, Livonia, Michigan 48154.

Q. What is your occupation?

A. I am a certified public accountant and a senior regulatory utility consultant with the firm Larkin & Associates, PLLC, certified public accountants and regulatory consultants.

Q. Please describe Larkin & Associates.

A. Larkin & Associates, PLLC, is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates, PLLC has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous gas, electric, water and wastewater, and telephone utility cases.

Q. Please summarize your professional experience.

A. Subsequent to graduation from the University of Michigan, and after a short period of installing a computerized accounting system for a Southfield, Michigan realty management firm, I accepted a position as an auditor with the predecessor CPA firm to Larkin & Associates in July 1979. Before becoming involved in utility regulation where the majority of my time for the past 31 years has been spent, I performed audit, accounting, and tax work for a wide variety of businesses that were clients of the firm.

During my service in the regulatory section of our firm, I have been involved in rate cases and other regulatory matters concerning numerous electric, gas, telephone, water, and sewer utility companies. My present work consists primarily of analyzing rate case and regulatory filings of public utility companies before various regulatory commissions, and, where appropriate, preparing testimony and schedules relating to the issues for presentation before these regulatory agencies.

My professional career has included over 31 years in public accounting and utility regulatory consulting at Larkin & Associates and its predecessor firm. I have performed work in the field of utility regulation on behalf of industry, PSC staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arkansas, Arizona, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, West Virginia, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. I have presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on many occasions. I have also presented seminars on utility accounting and ratemaking on behalf of various clients, and have taught at the Institute of Public Utilities sponsored by Michigan State University.

Q. What professional designations do you hold?

A. I hold the following professional designations:

- Certified Public Accountant (licensed in the State of Michigan)
- Attorney (licensed in the State of Michigan)
- Certified Rate of Return Analyst
- Certified Financial Planner™ professional

Q. Please summarize your educational background.

A. I received a Bachelor of Science degree in Business Administration (Accounting Major) with distinction from the University of Michigan - Dearborn, in April 1979. I passed all parts of the C.P.A. examination on my first sitting in 1979, received my C.P.A. license in 1981, and received a certified financial planning certificate in 1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law degree (J.D.) cum laude from Wayne State University, 1986. I also have participated each year in a variety of continuing professional education required to maintain my CPA license and CFP® certificate.

Since 1981, I have been a member of the Michigan Association of Certified Public Accountants. I am also a member of the Michigan Bar Association and the

Society of Utility and Regulatory Financial Analysts (SURFA)[1]. I have served as an arbitrator in disputes involving financial transactions as part of the National Association of Securities Dealers, Inc. (NASD) Dispute Resolution program and the Financial Industry Regulatory Authority, Inc. (FINRA). I have also been a member of the American Bar Association (ABA), and the ABA sections on Public Utility Law and Taxation.

Q. Have you prepared an appendix that contains additional information on your educational background and professional experience?

A. Yes. CUB Exhibit 1.1, attached to this testimony also summarizes some of my regulatory experience and qualifications.

Q. On whose behalf are you appearing?

A. I am testifying on behalf of the Citizens Utilities Board ("CUB") in response to the Commonwealth Edison Company ("ComEd" or "Company").

Q. Have you previously presented testimony before the Illinois Commerce Commission?

A. Yes, I have previously presented testimony before the Illinois Commerce Commission ("Commission") in a number of cases.

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[1] Formerly, the National Society of Rate of Return Analysts.

Q. Please describe the tasks you performed related to your testimony in this case.

A. I reviewed and analyzed data and performed other procedures as necessary to (1) obtain an understanding of the ComEd formula rate filing package as it relates to the Company's proposed rate decrease for electric distribution utility service and (2) formulate an opinion concerning the reasonableness of the Company's proposed distribution revenue requirement. These procedures included reviewing the Company's testimony and exhibits; reviewing ComEd's responses to the data requests of the Staff, the Illinois Attorney General's Office, CUB and other parties; issuing information requests; and analyzing ComEd's responses to them.

Q. What issues will you be addressing in your testimony?

A. I am recommending rate base and operating income adjustments to ComEd's formula rate filing. My recommended adjustments have been incorporated into the CUB revenue requirement model (CUB Ex. 1.2), which I am sponsoring in this case. I also address concerns with the methodology proposed by ComEd for annual reconciliations. That discussion includes a recommendation that an average test year rate base methodology be employed to measure ComEd's results in the annual reconciliations.

Q. Does your testimony comprehensively address all concerns that may exist with respect to ComEd's formula rate plan filing?

A. My testimony only addresses the specific concerns that I have identified within the available time and budgetary constraints. There may be other issues raised by other parties that are worthy of consideration that CUB may want to endorse. Failure to discuss or quantify an adjustment for a particular issue should not be construed as concurrence with ComEd's position. The lack of an adjustment at this point should not be construed to mean agreement with inclusion in rates, and CUB reserves the right to adopt the adjustments proposed by others.

Q. How is the remainder of your testimony organized?

A. My testimony is organized into the following sections:

II. Summary of Conclusions and Recommendations

III. Organization of Supporting Schedules

IV. Areas where ComEd Did Not Make the Commission Ordered Adjustments from the Decision in Docket No. 10-0467, ComEd's last rate case

V. Rate Base Adjustments

VI. Net Operating Income Adjustments

VII. Calculation Methodology for Annual Reconciliations

II. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. Please summarize your conclusions and recommendations.

A. Based on my review of the Company's testimony, on the discovery that has been conducted, on publicly available information, and on my experience in the area of regulatory accounting, policy, and revenue requirement determination, my conclusions and recommendations to date are as follows and summarized below:

- The following adjustments should be made to ComEd's proposed jurisdictional rate base:

Effect of CUB Adjustments to Rate Base	Schedule	Rate Base Impact	Estimated Revenue Requirement Impact
Cash Working Capital for Operating Expense - Lead/Lag Study Corrections	B-1	(45,752)	$ (6,166)
Remove Capitalized Restricted Stock from CWIP/Accumulated Depreciation	B-2	(787)	$ (106)
Reallocation of General and Intangible Plant - Jurisdictional	B-3	(18,197)	$ (2,452)
Capitalized Miscellaneous Disallowances	B-4	(492)	$ (66)
Adjustment for Three Years of Illinois Distribution Tax Credits Recorded in 2010	B-5	3,131	$ 422
Adjustment to Capitalized AIP -From 112.2% to 102.9% and 100% of Target	B-6	1,905	$ 257
Miscellaneous Jurisdicitional ADIT Components	B-7	(42,883)	$ (5,779)
Other Cash Working Capital Adjustments	B-8	(14,281)	$ (1,925)
Reserves for Accrued Vacation and Accrued Incentive, Net of Related ADIT	B-9	(43,913)	$ (5,918)
Jurisdictional ADIT on Bad Debt Reserve	B-10	(19,440)	$ (2,620)
Estimated ADIT Impact from Tax Over Book Depreciation on 2011 Distribution Plant Additions	B-11	(201,742)	$ (27,187)
Treat Supplemental Employee Retirement Plan ADIT as a Net Pension Asset Component	B-12	(5,067)	$ (683)
Total CUB Adjustments to Rate Base		$ (387,517)	$ (52,223)
Rate Base per Company's Filing	B	$ 6,647,180	
CUB Adjusted Rate Base	B	$ 6,259,663	

- The following adjustments show be made to ComEd's proposed jurisdictional net operating income:

Effect of CUB Adjustments on Net Operating Income	Schedule	Net Operating Income Impact	Estimated Revenue Requirement Impact
Miscellaneous Disallowances	C-1	$ 1,317	$ (2,185)
Remove Restricted Stock Expense	C-2	$ 1,157	$ (1,921)
Legal Fees Related to IRS Dispute-Sale of Fossil Generating Units	C-3	$ 417	$ (692)
Remove Photovoltaic Pilot Costs	C-4	$ 349	$ (580)
Depreciation Expense Adjustment from G&I reallocation	C-5	$ 299	$ (497)
Adjustment for Three Years of Illinois Distribution Tax Credits Recorded in 2010	C-6	$ 3,131	$ (5,197)
Interest Synchronization	C-7	$ (5,381)	$ 8,930
Adjustment for AIP-From 112.2% to 102.9% and 100% of Target	C-8	$ 1,355	$ (2,248)
Adjustment for AIP-Charged by BSC Based on Earnings	C-9	$ 2,283	$ (3,788)
Expense for Carrying Cost on Pension Asset for SERP Related ADIT	C-10	$ (195)	$ 323
Donations (not yet quantified)	C-11	$ -	$ -
Use Jurisdictional Allocation for Property Tax Expense Based on Same Methodology Used in Docket No. 10-0467	C-11	$ 2,016	$ (3,345)
Total CUB Adjustments to Operating Income		$ 6,749	$ (11,200)
Net Operating Income per Company's Filing	C	$ 572,088	
CUB Adjusted Net Operating Income	C	$ 578,837	

- As shown on CUB Ex. 1.2, Schedule A, ComEd's proposed jurisdictional revenue excess, of $43.6 million before the Trailer Bill, and $53.7 million after the Trailer Bill, should be adjusted to show a jurisdictional revenue excess of $117.1 million.

- For purposes of the annual reconciliation, an average test year rate base methodology should be employed to measure ComEd's results for the calendar year.
- Carrying cost on over- and under-collected balances should be computed as follows: Carrying costs on over-collections by ComEd should be computed at the larger of (1) ComEd's overall cost of capital or (2) ComEd's short term debt cost. Carrying costs on under-collections by ComEd should be computed at the smaller of (1) ComEd's overall cost of capital or (2) ComEd's short term debt cost.

III. ORGANIZATION OF SUPPORTING SCHEDULES

Q. Please identify the schedules that you are sponsoring in CUB Exhibit 1.2.

A. I am sponsoring all of the schedules in the CUB revenue requirement model, CUB Exhibit 1.2.

Q. How are CUB's revenue requirement schedules organized?

A. CUB's accounting schedules and electric distribution revenue requirement determination for ComEd are presented in CUB Ex. 1.2. They are organized into summary schedules and adjustment schedules. The summary schedules consist of Schedules A, A-1, B, B.1, C, C.1 and D. CUB Ex. 1.2 also contains rate base adjustment Schedules B-1 through B-12 and net operating income adjustment Schedules C-1 through C-12.

Q. What is shown on Schedule A of CUB Ex. 1.2?

A. CUB Ex. 1.2 presents the CUB Accounting Schedules and revenue requirement determination. Schedule A, page 1, presents the overall financial summary, giving effect to all the adjustments I am recommending in my testimony. This schedule presents the change in the Company's gross revenue requirement needed for the Company to have the opportunity to earn the rate of return on CUB's adjusted jurisdictional rate base for ComEd's electric distribution service. The rate base and operating income amounts are taken from Schedules B and C, respectively. The overall rate of return is provided on Schedule D.

Column A of Schedule A replicates ComEd's proposed calculations of the 2010 revenue sufficiency. Column B presents CUB's determination of the 2010 revenue sufficiency. Column C shows differences between ComEd's filing and the CUB adjusted amounts.

The operating income deficiency shown on line 5 of Schedule A is obtained by subtracting the operating income available on line 4 (operating income as adjusted) from the required operating income on line 3. Line 7 represents the gross revenue requirement, which is obtained by multiplying the income deficiency by the gross revenue conversion factor ("GRCF"). The derivation of the GRCF is shown on Schedule A-1. Line 8 shows a comparison of the results of the CUB recommendations, which show a jurisdictional revenue excess of \$114.1 million, in comparison to the results of ComEd's alternative filing with the results of the Trailer Bill of \$53.681 million.

Q. Has ComEd recently acknowledged the passage of the Trailer Bill?

A. Yes. On January 11, 2012, ComEd sent a notification acknowledging that on December 30, 2011, the Trailer Bill was signed by Governor Quinn and became law as PA 97-0646. ComEd will, therefore, be offering into evidence those alternative documents applicable to the law as modified by the Trailer Bill. In general, those documents are the exhibits that have the suffix "TB," reflecting their applicability to the Trailer Bill. At the time ComEd prepared the submissions that led to this Docket, no one was certain if or, if so, when the Trailer Bill (HB 3036) referred to therein would become law. Because of that uncertainty, the CUB presentation and adjustments have been made in the context of ComEd's primary filing, which had not reflected the impact of the Trailer Bill. As summarized on CUB Ex. 1.2, Schedule A, in column A, ComEd shows a 2010 jurisdictional revenue excess of $53.681 million with the Trailer Bill versus the $43.628 million jurisdictional revenue excess without the Trailer Bill. The primary cause for the difference of approximately $10 million is the reduction in the return on equity from 10.25 percent to 10.05 percent.

Q. What is shown on CUB Ex. 1.2, Schedule A, page 2?

A. Schedule A, page 2, presents a reconciliation of CUB's recommendations with ComEd's filing.

Q. What is shown on Schedule A-1?

A. Schedule A-1 shows the derivation of the GRCF. The GRCF is used to convert the net operating income deficiency into a revenue deficiency amount.

Q. How does the GRCF recommended by CUB compare with the GRCF contained in ComEd's filing?

A. As shown on Schedule A-1, both CUB and ComEd have used a GRCF of 1.6596.

Q. What is shown on Schedule B?

A. Schedule B presents ComEd's proposed adjusted 2010 test year rate base and CUB's proposed adjusted 2010 test year rate base for the ComEd formula rate plan. The beginning rate base amounts presented on Schedule B are taken from the Company's filing for the test year, specifically ComEd Schedule B-1. CUB's recommended adjustments to rate base are summarized on CUB Ex. 1.2, Schedule B.1, and are shown on column B of Schedule B.

Schedules B-1 through B-12 provide further support and calculations for the rate base adjustments CUB is recommending.

Q. What is shown on Schedule C?

A. The starting point on Schedule C is ComEd's adjusted test year net operating income, as provided on Company Schedule C-1. CUB's recommended adjustments to ComEd's adjusted test year revenues and expenses are summarized on CUB Ex. 1.2, Schedule C.1, and are shown on Schedule C in column B. Each of the adjustments is discussed in my testimony. CUB's adjusted jurisdictional net operating income results are shown on CUB Ex. 1.2, Schedule C, in column C.

Schedules C-1 through C-10 and C-12 provide further support and calculations for the net operating income adjustments CUB is recommending. It is anticipated that an adjustment for ComEd's proposed amount of charitable contributions will also be necessary, and Schedule C-11 has therefore been reserved for that, but an adjustment has not be quantified at this time, so that schedule is not currently being used.

Q. What is shown on Schedule D?

A. Schedule D summarizes the capital structure and cost of capital that was used by ComEd and the capital structure and cost of capital that is used by CUB. At this point, the only difference is the return on equity ("ROE"). Because HB 3036 (the Trailer Bill) has now been signed in to law, it is appropriate and necessary to use the reduced ROE of 10.05 percent (resulting from the sum of the applicable calendar year average of 30-year U.S. Treasury Bonds and 580 basis points) to determine ComEd's revenue requirement under the formula rate plan. ComEd's pre-Trailer bill filing used an ROE of 10.25 percent (based on adding 600 basis points to the Treasury Bond average).

Q. Have you attached to your testimony any Exhibits containing additional details concerning some of the CUB adjustments that you are sponsoring?

A. Yes. Attached to my testimony is CUB Exhibit 1.3, which contains selected responses to discovery that are discussed in my testimony and/or referenced in the exhibits and schedules I am sponsoring.

Q. How have you organized the discussion of issues in your testimony?

A. The remainder of my testimony is organized around adjustments and issue discussions. Each adjustment to rate base and net operating income that I recommend is discussed below in a separate section of the testimony. My recommendations concerning the annual reconciliations are also presented in separate sections of the testimony.

IV. AREAS WHERE COMPANY DID NOT MAKE COMMISSION ORDERED ADJUSTMENTS FROM DOCKET NO. 10-0467, COM ED'S LAST RATE CASE

Q. When was the Commission's Order issued in ComEd's last rate case?

A. In Docket No. 10-0467, ComEd's last rate case, the Commission's Order was issued on May 24, 2011.

Q. Has ComEd identified several areas where ComEd did <u>not</u> conform its formula rate filing to the approaches used by the Commission in its May 24, 2011 Order in Docket No. 10-0467?

A. Yes, in response to AG 1.06, page CFRC 0003261[2], ComEd identified the following ten areas where it treated items differently in its formula rate filing than they were treated in the final Order in ICC Docket No. 10-0467:

1) Allocation of G&I plant
2) Restricted stock awards
3) Perquisites and awards
4) Sporting activity expense
5) Legal fees related to fossil sale
6) Interest on Customer deposits included in Operating Expenses
7) Cash working capital
8) Real estate taxes
9) Depreciation expense for pro forma plant additions
10) Photovoltaic pilot costs

Additionally, as explained in conjunction with CUB adjustment C-12, ComEd also proposed to increase jurisdictional property tax expense by approximately $3.345 million based on the use of a jurisdictional allocation method that is inconsistent with the method and allocation used in Docket No. 10-0467.

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[2] Copies of ComEd 's responses to discovery that are referenced in my testimony are provided in CUB Ex. 1.3.

Q. Does ComEd's failure to apply the several ratemaking treatments used by the Commission in the Docket No. 10-0467 Order present the only concerns with ComEd's formula rate filing?

A. No. There are several other additional concerns with ComEd's determination of its distribution revenue requirement in the Company's formula rate filing.

Q. Are you recommending adjustments in response to ComEd's failure to make adjustments made by the Commission in ComEd's last rate case, Docket No. 10-0467, and for additional concerns regarding ComEd's formula rate plan filing?

A. Yes. As described below, I am recommending several adjustments to rate base and 2010 operating expenses to address such concerns.

V. RATE BASE ADJUSTMENTS

B-1, Cash Working Capital for Operating Expense-Lead/Lag Study to conform with the Commission's Order in Docket No 10-0467 for Revenue-Based Taxes and Intercompany Payment Lag

Q. What adjustments did the Commission require for ComEd's allowance for cash working capital in ComEd's last rate case, Docket No. 10-0467?

A. The Commission required the following adjustments for ComEd's allowance for cash working capital in its last rate case, Docket No. 10-0467:

1) Energy Assistance Charges/Renewable Energy pass-through tax ("EAC/REC"): use 0 revenue lag days and 35.21 expense lead days as opposed to ComEd's proposed 42.11 revenue lag days and 26.11 expense lead days;
2) Gross Receipts/Municipal Utility pass-through tax ("GRT/MUT"): use 0 revenue lag days and 44.21 expense lead days as opposed to ComEd's proposed 42.11 revenue lag days and 26.11 expense lead days; and
3) Intercompany expenses: use 45.35 expense lead days as opposed to ComEd's proposed 30.35 expense lead days.

Q. Where did ComEd reflect those Commission ordered adjustments in its formula rate filing?

A. ComEd did not appropriately reflect those Commission-Ordered adjustments. ComEd's formula rate filing presents the Company's cash working capital at ComEd's Exhibit 8.1. ComEd failed to reflect the Commission's ordered adjustments for EAC/REC revenue lag days and expense lead days, GRT/MUT revenue lag days, and expense lead days for Intercompany expenses in its formula rate filing. In his testimony at page 21, ComEd's witness Mr. Hengtgen states:

> ...the lag for the EAC/REC, GRT/MUT... is identical to the revenue lag. This differs from the last study and the Commission's rulings in Docket No. 10-0467...while the lead times for the EAC/REC and the GRT/MUT are very similar to the last study and the final Order in Docket No. 10-0467...

As found by the Commission in its final Order in Docket No. 10-0467, there is a net period of time in which ComEd has the use of money collected from rate payers for EAC/REC and GRT/MUT. ComEd's formula rate plan filing does not adequately reflect that. ComEd's formula rate plan filing fails to conform with the treatment found to be appropriate for these items in Docket No.10-0467. ComEd also did not reflect the Commission ordered adjustments for Intercompany expenses. Adjustments must therefore be made to ComEd's proposed cash working capital to correct for these differences. I discuss the necessary adjustments below.

Q. Please describe Schedule B-1, Adjustment to Reduce Cash Working Capital.

A. Schedule B-1 shows the adjustment to reduce the Cash Working Capital ("CWC") component of rate base based on adjustments to the lead lag study presented by ComEd to reflect the treatment of EAC/REC, GRT/MUT and intercompany changes consistent with the Commission's final Order in Docket No. 10-0467:

1) Consistent with the Commission's Order in Docket No. 10-0467, my calculation uses 45.55 expense lead days for intercompany expenses while the Company used 30.55 expense lead days for its calculation.
2) My calculation uses zero revenue lag days and 35.21 expense lead days for the Energy Assistance Charge/Renewable Energy pass through tax while the Company used 51.25 revenue lag days and 30.05 expense lead days.
3) My calculation uses zero revenue lag days for Gross Receipt/Municipal Utility pass through tax while the Company used 51.25 revenue lag days.

Q. Please explain your first change to the Company's calculation, an increase in the number of lead days for intercompany expenses.

A. The Company's filing, at ComEd Ex. 8.2, indicates that the Company remits payment to affiliates on or around the 15th of the month following the provision of service. However, as the Commission found in its decision in Docket No.10-0467, the timing of the payments to affiliates is within the Company's discretion. Therefore, I propose to add 15 days to the Company's intercompany billings to reflect payment within 30 days of the invoice instead of approximately 15 days used by the Company. This results in expense lead days of 45.55 days which is 15 days longer than the Company's expense lead days of 30.55 days. The use of 45.55 lead days, by adding 15 days, is consistent with the approach used by the Commission for the intercompany expense payment lead in its Order in Docket No. 10-0467.

Q. Please explain your second change, to reflect zero revenue lag days and 35.21 expense lead days for the Energy Assistance Charge/Renewable Energy pass through tax.

A. The Company used 51.25 revenue lag days and 30.05 expense lead days for this item. The Company, through witness Mr. Hengtgen, asserts the reason for 51.25 revenue lag days (ComEd Ex. 8.0 Page 22):

> ...all these taxes and charges are collected in the same manner and at the same time...as all other revenue of ComEd. ...While I believe it is appropriate and proper to include a lag which is identical to the revenue lag, the important point is that the timing difference between when ComEd collects these amounts and when ComEd pays

> these amounts, is captured properly and the appropriate cash working capital requirement related to these items are reflected in rate base.

I do not agree with the Company on its revenue lag days for the Energy Assistance Charge/Renewable Energy pass through tax because the manner and the time of collection of this item are different from other revenue of the Company. The Statute governing the Energy Charges/Renewable Energy pass-through tax provides that a public utility engaged in the delivery of electricity shall assess each of its customer accounts a monthly charge. The utility shall remit all moneys received as payment to the Illinois Department of Revenue by the 20th day of the month <u>following</u> the month of collection. Based on this provision, the Company has the use of these moneys for a full 20 days <u>after</u> the month of collection. The lag is thus appropriately determined by totaling the midpoint of the month in which the receipts were collected (15.21 days by the Company's calculation), and adding 20 days of the month after collection occurred. This results in 35.21 expense lead days. There is no revenue lag because the Company did not provide any service in connection with this pass through tax. Consequently, the net lag is 35.21 days.

Q. Is the approach you used for this lag consistent with the Commission's determination in Docket No. 10-0467?

A. Yes. The Commission's Order in Docket No. 10-0467, at page 48 states that:

> For the EAC/REC tax, the utility shall remit all moneys received as payment to the Illinois Department of Revenue by the 20th day of the month following the month of collection... The Commission concludes that the CWC

> calculation...should reflect zero revenue lag days and 35.21 expense lead days for EAC/REC pass-through taxes...

Q. Please explain your third change, to reflect zero revenue lag days for the Gross Receipts/Municipal Utility pass through tax.

A. The Company used 51.25 revenue lag days for this item based on the same reason stated above. Zero revenue lag days should be used because the Company did not provide any service in connection with this pass through tax.

Q. Is the approach you used for this lag consistent with the Commission's determination in Docket No. 10-0467?

A. Yes. The Commission's Order in Docket No. 10-0467, at page 48 states that:

> Under the GRT/MUT tax, this ordinance requires ComEd to file a monthly tax return to accompany the remittance of such taxes, due by the last day of the month following the month during which such tax is collected...The Commission concludes that the CWC calculation for GRT/MUT pass-through taxes should reflect zero revenue lag days...

Q. What net adjustment to rate base is produced by these corrections to the Company's proposed allowance for cash working capital?

A. As shown on CUB Ex.1.2, these corrections reduce ComEd's proposed amount of cash working Capital by $45.752 million.

Q. Do the adjustments to cash working capital that you have described above adequately address all of the concerns about ComEd's proposed calculation of cash working capital for the formula rate plan?

A. No. There are a number of additional concerns regarding ComEd's proposed calculation of cash working capital for the formula rate plan, including the excessive revenue collection lag and the net cash working capital required for pensions. My testimony describes each of those additional concerns, and I propose adjustments which are shown on CUB Ex. 1.2, Schedule B-8, to address them. I address those additional cash working capital concerns after addressing some other aspects of the distribution rate case where ComEd's formula rate plan did not follow the rate making treatment used by the Commission in its Order in Docket No. 10-0467.

B-2, Remove Capitalized Restricted Stock from CWIP/Accumulated Depreciation

Q. Please describe Schedule B-2, Adjustment to Remove Capitalized Restricted Stock from CWIP/Accumulated Depreciation

A. CUB Ex. 1.2, Schedule B-2 shows my adjustment to remove the capitalized restricted stock from CWIP/Accumulated Depreciation. This adjustment reduces the rate base by $787,000.

Q. Why is the cost of restricted stock being removed from ComEd's proposed rate base and operating expense?

A. Restricted stock costs are related to the performance of the parent company's stock and the dividends paid on such stock. As such, the costs should be borne by shareholders, not ratepayers.

Q. Were the costs of restricted stock removed from ComEd's proposed cost of service in ComEd's last rate case, Docket No. 10-0467?

A. Yes. Such costs were removed from the cost of service in ComEd's last case, Docket No. 10-0467. The final Order in Docket No. 10-0467 at page 65 states:

> "100% of the cost of the Exelon 2009 Key Manager Restricted Stock Award Program is disallowed."

Q. Is there a related adjustment to expense?

A. Yes. CUB Ex 1.2, Schedule C-2 shows the related adjustment of removing restricted stock expense from operating expense.

B-3, Reallocation of General and Intangible Plant

Q. Please describe the adjustment for the Reallocation of General and Intangible (G&I) Plant.

A. As shown on CUB Ex. 1.2, Schedule B-3, this adjustment reduces ComEd's proposed rate base of $18.197 million to reflect the rejection of ComEd's proposed modification of the methodology.

Q. What functional approach was approved in the final Order in ICC Docket No. 10-0467?

A. In Docket No. 10-0467, ComEd proposed to switch from a set of generic functional allocators to a single generic functional allocator based on Wages and Salaries for certain accounts. For other G&I accounts ComEd proposed to replace the direct assignment methodology with a generic functional Wages and Salaries allocator. As described at page 42 of the final Order in Docket No. 10-0467, the Commission rejected those ComEd proposed changes to the allocation methodology.

Q. What changes to the allocation methodology does ComEd Propose in its current Formula Rate Plan Filing?

A. ComEd proposes that the formula rate uses a direct assignment for Communication Equipment, the largest component of G&I Plant, and a Wages and Salaries allocator for the remainder.

Q. How does the Company attempt to justify the changes?

A. ComEd witness Houtsma's direct testimony explains the Company's proposed allocation method changes at ComEd Ex. 2.0, pages 29 and 30 as follows:

> The wages and salaries allocator is also used by FERC in the determination of the transmission rate, resulting in consistency between jurisdictions and ensuring that the costs are neither over-recovered nor under-recovered.

Q. What is the result of ComEd's proposed allocation methodology changes?

A. The result is to shift cost into the jurisdictional revenue requirement for electric distribution service. As ComEd's response to PR 1.02 states, if the previously allowed allocation factors for Accounts 389, 390, 392, and 394-396 were used in the formula rate template, jurisdictional rate base would decrease by approximately $18 million dollars, reducing the revenue requirement by approximately $2.1 million dollars. Jurisdictional depreciation expense would be reduced by $492,000 dollars. The revenue requirement reduction would total up to approximately $2.5 million dollars, which is a significant impact.

Q. Should these ComEd proposed changes to allocation methods be rejected for the purpose of determining the Company's distribution revenue requirement under the formula rate plan?

A. Yes. In Docket No. 10-0467, the Commission considered and rejected ComEd's proposed changes to allocation methods for G&I plant and found that the objective for cost allocation should be cost causation principles, not achieving consistency with the determination of transmission rate.

Q. What adjustment should be made?

A. As stated above, the allocation changes proposed by ComEd are not consistent with the Commission's findings and final Order in ComEd's last rate case, ICC Docket No. 10-0467, where the Commission considered and rejected similar allocation methodology changes that ComEd proposed. ComEd's proposed jurisdictional rate base should be reduced by $17.7 million and depreciation expense should be reduced by $492,000, as shown on CUB Ex. 1.2, Schedule B-3.

Q. Is there a related adjustment to depreciation expense?

A. Yes. CUB Ex 1.2, Schedule C-5 shows the related adjustment for depreciation expense.

B-4, Remove Capitalized Miscellaneous Disallowances

Q. Please describe Schedule B-4, Adjustment to Remove Capitalized Miscellaneous Disallowance.

A. Schedule B-4 removes the capitalized Other Stock Awards and Perquisites of $40,000, Retention Awards Cost of $427,000, and 50% of Performance Awards to Shareholders of $25,000, totaling capitalized miscellaneous disallowances of $492,000.

Q. Is this adjustment consistent with the treatment of such costs in the Commission's final Order in ComEd's last rate case, Docket No. 10-0467?

A. Yes. The Commission's final Order in Docket No. 10-0467, at page 103, removed such costs, stating as follows:

> Therefore, the AG/CUB proposals to amortize these expenses [retention awards] over four years, and to decrease the amount for perquisites and awards by half, is adopted.

Q. Is there any adjustment to remove related expense?

A. Yes. As shown on CUB Ex. 1.2, Schedule C-1, the related expense has been removed from ComEd's proposed operating expense.

B-5, Adjustment for Three Years of Illinois Distribution Tax Credits Recorded in 2010

Q. Please describe Schedule B-5, Adjustment for Three Years of Illinois Distribution Tax Credits Recorded in 2010.

A. CUB Ex 1.2 Schedule B-5 adjusts ComEd's rate base for an unamortized balance relating to the three years of Illinois Distribution Tax Credits that ComEd recorded in 2010. As described below, in conjunction with the amortization adjustment shown on Schedule C-6, I recommend that the three years of Illinois Distribution Tax Credits be normalized over three years, whereas ComEd had proposed a five-year normalization for such credits. This adjustment increases ComEd proposed rate base by $5.2 million dollars and Accumulated Deferred Income Tax by $2.1 million dollars, increasing ComEd proposed rate base by $3.1 million. The related adjustment for the amortization expense is shown in CUB Ex 1.2, Schedule C-6.

B-6, Adjustment for Capitalized AIP Over 100 Percent of Target

Q. Please explain the adjustment on CUB Ex. 1.2, Schedule B-6.

A. This adjustment removes from rate base the capitalized portion of 2010 AIP cost that was capitalized for amounts in excess of 100 percent of the target level. This adjustment is related to an adjustment to operating expenses (CUB Adjustment C-8) and the need for making this adjustment is discussed in detail in conjunction with that related expense adjustment.

B-7, Miscellaneous Accumulated Deferred Income Taxes

Q. Please explain the adjustment on CUB Ex. 1.2, Schedule B-7.

A. This adjustment removes debit-balance Accumulated Deferred Income Tax (ADIT) components from rate base, consistent with the treatment of those items in ComEd's recent rate case, Docket No. 10-0467. Some of the ADIT items that ComEd has added to rate base in its formula rate plan filing should not be included in rate base and are not consistent with the ratemaking treatment applied for such items in ComEd's last rate case. Those items are being removed on Schedule B-7. This reduces ComEd's proposed rate base by $42.883 million. In another CUB adjustment, B-9, I address how the reserves for accrued vacation and accrued incentive pay, which ComEd has not reflected in its determination of cash working capital, should be reflected as offsets to rate base for non-investor provided capital. In conjunction with that adjustment, I also restore the related ADIT in account 190 for the accrued vacation and accrued incentive pay.

B-8, Other Cash Working Capital Adjustments

Q. What is cash working capital?

A. Cash working capital is the cash needed by the Company to cover its day-to-day operations. If the Company's cash expenditures, on an aggregate basis, precede the cash recovery of expenses, investors must provide cash working capital. In that situation a positive cash working capital requirement exists. On the other hand, if revenues are typically received prior to when expenditures are made, on average, then ratepayers provide the cash working capital to the utility, and the negative cash working capital allowance is reflected as a reduction to rate base. In this case, the cash working capital requirement is a reduction to rate base as ratepayers are essentially supplying these funds.

Q. Does ComEd have a positive or negative cash working capital requirement?

A. Based on its calculations, ComEd claims to have a positive cash working capital requirement. However, after making necessary adjustments shown on Schedule B-8, ComEd has a negative cash working capital requirement. In other words, customers and other non-investor sources are essentially supplying the funds used for the day-to-day operations of the Company before the Company is paying for the cash expenditures. This net source of non-investor supplied funds should be reflected in the determination of jurisdictional rate base.

Q. Please explain why other adjustments to Cash Working Capital, besides those shown on CUB Ex. 1.2, Schedule B-1, are needed.

A. A number of other concerns exist with respect to ComEd's proposed Cash Working Capital allowance, including:

1) The revenue collection lag is excessive and has apparently resulted from the arbitrary calculation method employed by ComEd which fails to account for and fully remove amounts carried in Accounts Receivable that become uncollectible.

2) ComEd's calculation applied the same lag for Base Payroll and Withholdings to the test year incentive pay.[3] That understates the payment lag. The incentive pay is earned throughout the year but is paid out by mid-February of the following year for annual incentive compensation, and the current year's portion of long-term incentive compensation is paid by a date in February of the following year.[4] Consequently, the payment lag for incentive compensation should be approximately 227.5 days for incentive compensation:

Description	Days
Number of days in year	365.00
Mid-point	182.50
Days through mid-February of following year	45.00
Estimated lead that applies to accrued incentive compensation	227.50

Thus, using a revised lead time of approximately 227.5 days for the incentive compensation expense would be one way to correct for this. Rather than applying such a lag in the lead-lag study, I address this item

[3] See, e.g., ComEd's responses to AG 6.06(a) and (f) Corrected.

[4] See, e.g., ComEd's response to AG 5.04.

below, in conjunction with CUB Adjustment B-9, by using the average 2010 test year jurisdictional balance sheet amount for accrued incentive compensation for this source of non-investor supplied capital that offsets rate base, net of the related ADIT.

3) ComEd's calculation included a net Cash Working Capital requirement amount for pension and OPEB costs. According to ComEd's response to Data Request AG 1.27:

> Since these amounts are already included in rate base or earning a return...zero lag days are used. No separate measurement of the cash flows was done and no other analyses, workpapers, projections or correspondence exist supportive of the zero lead days.

ComEd thus, applied a zero expense lead for this, but effectively also applied its proposed revenue lag of 51.25 days, creating a working capital requirement of approximately $15.836 million which should be removed:

Description	($000s)
Accrued Pension and OPEB Expense:	$ 112,785.00
Effective CWC Factor	0.140411
Cash Working Capital Requested by ComEd for Accrued Pensions and OPEB	$ 15,836.00
ComEd Proposed:	
Expense Lag, in Days	51.25
Revenue Lag, in Days	0
Net Lag	51.25
Effective CWC Factor (Net Lag / 365 days)	0.140411

4) ComEd has applied its expense lead days applicable to "Other O&M expense" of the CWC calculation to an Accounts Payable balance associated with CWIP at line 26. Both Accounts Payable and CWIP are balance sheet accounts. It does not make sense to apply an expense lead

to a balance sheet account, Accounts Payable, as ComEd has done. ComEd has quantified an Accounts Payable balance believed to be associated with the non-investor provided funding of CWIP that is included in rate base. I recommend that this Accounts Payable balance related to CWIP be directly included in the CWC calculation since it is the best indicator of how much of the Company's CWIP balance has not been funded in cash, but rather is being funded by ComEd's vendors. The Accounts Payable balance associated with CWIP of $1.283 million should be deducted directly in the determination of the Cash Working Capital requirement because that represents the amount of non-investor supplied funds that are associated with CWIP. I show the correction for this at Schedule B-8, line 30.

Q. Please explain how you adjusted for ComEd's proposed revenue lag.

A. ComEd proposed a revenue lag of 51.25 days, including a collection lag of 32.34 days that appears to be excessively long. The excessive collection lag has resulted from ComEd's failure to fully remove uncollectibles from the Accounts Receivable balances in computing the revenue collection lag. ComEd collects cash only from customers who pay their bills. No cash is collected from customers who do not pay their bills. Thus, the revenue collection lag should be computed only on the collectible portion of Accounts Receivable that becomes actual cash payments. On its balance sheet, Accounts Receivable is a current asset; however, that account has an offset, or contra account, which is the

Accumulated Provision for Uncollectible Accounts Receivable. ComEd failed to deduct that Accumulated Provision for Uncollectible Accounts from its Accounts Receivable in its calculation of the revenue collection lag. That failure significantly overstates the collection lag. This can be corrected by adjusting the collection lag to exclude uncollectible balances.

On January 1 and December 31, 2010, ComEd's Accumulated Provision for Uncollectible Accounts Receivable was $77.205 million and $80.358 million respectively, indicating a 2010 test year average of approximately $78.782 million. Approximately 34.8707 percent of ComEd's revenue is for delivery service. Applying the delivery service revenue portion of total revenue to the average 2010 Accumulated Provision for Uncollectible Accounts Receivable indicates a jurisdictional amount of approximately $27.472 million of average daily provision. Multiplying that by 365 days and dividing it by the distribution service revenue indicates that the collection lag (and revenue lag) should be reduced by approximately 4.5 days to fully remove the impact of Uncollectible accounts that ComEd carried in its Accounts Receivable balance. Calculations are shown on CUB Ex. 1.2, Schedule B-8, page 2, lines 13-20.

Q. The Commission did not adopt an adjustment proposed by an AG/CUB witness in Docket No. 10-0467 for a reduction to ComEd's collection lag. Why should the Commission adopt an adjustment for the ComEd collection lag in the current proceeding?

A. The Commission should adopt an adjustment for the ComEd collection lag in the current proceeding because it is necessary to properly compute the amount of cash working capital. The principle involved, as noted above, is simple: ComEd collects cash only from customers who pay their bills. No cash is collected from customers who do not pay their bills. Thus, the revenue collection lag should be computed only on the portion of Accounts Receivable that becomes actual cash payments. ComEd computed its collection lag using Accounts Receivable that did not have the related Accumulated Provision for Uncollectible Accounts fully removed. As a result, ComEd's collection lag is significantly overstated. A reduction of approximately 4.5 days is necessary.

Q. Did you also reflect impacts from CUB expense adjustments?

A. Yes.

Q. What is your recommended jurisdictional cash working capital allowance for ComEd?

A. As shown on CUB Ex. 1.2, Schedule B-8, page 1, line 31, I recommend a net cash working capital allowance for ComEd of negative $10.958 million. This reduces ComEd's requested amount by approximately $60 million. Net of the adjustment made on CUB Ex. 1.2, Schedule B-1, a reduction of $14.281 million is needed to address the cash working capital issues noted above, as shown on Schedule B-8, page 1, line 35.

B-9, Reserves for Accrued Vacation and Accrued Incentive Pay, Net of Related ADIT

Q. Please explain the adjustment to jurisdictional rate base for the Reserves for Accrued Vacation and Accrued Incentive Pay, Net of Related ADIT.

A. ComEd's Corrected Response to AG 2.06 stated that:

> Accrued Vacation and Accrued Incentive Pay are current liabilities and as such do not figure directly in the determination of rate base. The charges that generate these current liabilities are used in the Cash Working Capital study.

ComEd reflected vacation pay expense and the incentive pay expense in its total payroll expense in the cash working capital study at the normal payroll lag, and did not reflect the longer lag related to these items which are accrued during the course of the year and are paid after the end of the year. As noted above, the expense lead for the accrued incentive compensation would need to be approximately 227.5 days. Because the source of funds provided by the longer lag in payment of vacation pay and incentive pay is not specifically recognized in the calculation of cash working capital, the accrued liabilities for these items should be included in operating reserves. The liability for vacation pay represents vacation pay accrued in excess of what has actually been paid. As employees used their vacation time in subsequent years, the vacation pay accrual is effectively disbursed.

ComEd's response to AG 5.04 indicates that Annual Incentive Plan awards accrued during the year are paid out to employees mid-February of the succeeding year. Long Term Incentive Plan is paid out in thirds over three years (response to

AG Data Request 5.04). This lag in payment creates a source of non-investor supplied funds that is not recognized in the cash working capital calculation.

The lag in payment of vacations and incentive compensation is considerably longer than the lag associated with payroll that has been reflected in the lead-lag study. Deducting the related accrued liability balances from rate base, net of the related ADIT is thus an appropriate way of reflecting these sources of non-investor supplied capital. Additionally, if the related ADIT debit balances are included in rate base, then the accrued liabilities giving rise to those deferred taxes should be included in the operating reserves deducted from rate base.

Q. What net adjustment should be made?

A. As shown on CUB Ex. 1.2, Schedule B-9, jurisdictional rate base should be reduced by $44.164 million for accrued vacation, and by $28.714 for accrued incentive compensation, for a total increase to operating reserves of $72.878 million. Net of related debit-balance ADIT of $28.965 million, rate base is reduced by $43.913 million.

B-10, Jurisdictional ADIT on Bad Debt Reserve

Q. Please explain the adjustment to jurisdictional rate base for ADIT on the Bad Debt Reserve.

A. This item of ADIT should follow the allocation of bad debt expenses. As shown on CUB Ex. 1.2, Schedule B-10, the ADIT on the Bad Debt Reserve should be jurisdictionally allocated in the same proportion to bad debt expense. Using a jurisdictional allocation of 34.8707 percent, this reduces ComEd's proposed rate base amount by $19.440 million.

B-11, Estimated ADIT Impact from Tax Over Book Depreciation on 2011 Distribution Plant Additions

Q. Please explain the adjustment to jurisdictional rate base for ADIT related to Tax Over Book Depreciation on 2011 Distribution Plant Additions.

A. ComEd's filing reflects a projection of 2011 Plant additions and Accumulated Depreciation but does not reflect a projection of related 2011 ADIT for the difference between book and tax depreciation. Because the tax law provides for the opportunity for 100 percent bonus tax depreciation on qualifying assets, this is a significant omission and if not adjusted will overstate rate base for the inception rates for the ComEd formula rate plan.

Q. What do you recommend?

A. I recommend that an estimated amount of the 2011 ADIT for the difference between book and tax depreciation be reflected as an offset to jurisdictional rate base. On rebuttal, ComEd should provide its most accurate estimate of this. The final amount of 2011 tax depreciation will not likely be known until ComEd files its income tax returns for tax year 2011. However, because we are now into 2012, presumably ComEd will have a reasonably accurate, although not final, estimate of this impact. Because this impact is likely to be so significant on ComEd's jurisdictional distribution service rate base, reflecting a best estimate of this impact at this time, in establishing formula rate plan inception rates, should help minimize the differences in the reconciliation phase for 2011.

Q. What estimate do you propose at this time?

A. As shown on CUB Ex. 1.2, Schedule B-11, I estimate 2011 ADIT for the difference between book and tax depreciation on ComEd's 2011 distribution plant additions should be in the range of $110.1 million to $224.6 million based on assuming that 50 percent to 100 percent of ComEd's 2011 distribution plant additions will qualify for 2011 bonus tax depreciation. For purposes of a placeholder adjustment at this time I have used $201.7 million, as shown on Schedule B-11. ADIT in account 283, which is an offset to jurisdictional rate base, has been increased by $201.7 million, and jurisdictional rate base is decreased by that same amount. As noted above, in rebuttal, ComEd should provide its most accurate estimate of the impact of 2011 tax depreciation on distribution and other plant that ComEd has included in its 2011 plant projections, including general and intangible plant.

B-12, Treat SERP ADIT as a Net Pension Asset Component

Q. Please explain the adjustment to jurisdictional rate base to treat ADIT related to the Supplemental Employee Retirement Plan (SERP) as a Net Pension Asset Component.

A. In Docket No. 10-0467, a carrying cost for ComEd's pension asset was provided at a long-term debt cost rate. In its formula rate filing, ComEd included a rate base addition for SERP related ADIT in account 190. This ADIT amount should be included in the pension funding cost calculation, rather than in jurisdictional rate base. ComEd's response to AG 3.03 that it "believes it would be appropriate to include the SERP-related deferred taxes as part of the pension funding cost calculation (ComEd Ex. 4.1, Sch. C-3, Line 2), rather than in the overall rate base calculation." Eliminating the SERP-related ADIT from the jurisdictional rate base calculation reduces the Company's jurisdictional rate base by $5.067 million, as shown on CUB Ex. 1.2, Schedule B-11.

Q. Is there a related adjustment to expense?

A. Yes. As shown on CUB Ex. 1.2, Schedule C-10, expense is increased by $323,000 by applying the 6.37 cost rate to the $5.067 million.

VI. NET OPERATING INCOME ADJUSTMENTS

C-1, Miscellaneous Expense Disallowances

Q. Please explain the adjustment to 2010 Miscellaneous Expense Disallowances.

A. ComEd's proposed operating expenses should be reduced by $2.185 million as shown on CUB Exhibit 1.2, Schedule C-1, for expenses that are not necessary to the provision of utility service. This reduced amount consists of $57,000 for sporting activity/suite/sponsorship expenditures, $203,000 for other stock awards and perquisites, $1.793 million for normalized retention awards cost, and $132,000 for the removal of 50% of performance awards to reflect allocation of such cost to shareholders.

Q. Explain why the expense for sporting activities should be removed.

A. Expense should be reduced by $57,000 on a jurisdictional basis to remove the cost of sporting activity/suite/sponsorship expenditures. The Company agrees to remove this amount from its operating expense, as described in its response to ST 1.01:

> [C]ertain amounts for sporting event tickets and catering were charged to clearing accounts and ultimately redistributed to above-the-line accounts. As a result, **approximately $56.5K was included in ComEd's revenue requirement as jurisdictional operating expense**... ComEd will remove these amounts from its revenue requirement...in conjunction with its submission of rebuttal testimony.

(Emphasis supplied.)

This expense is not necessary for the provision of utility service, and should therefore be excluded. Exclusion of the sporting expense is also consistent with the treatment of this expense in ComEd's last rate case, Docket No. 10-0467.

Q. Please explain the exclusion of the expense for perquisites and other awards in CUB Exhibit 1.2, Schedule C-1.

A. ComEd's response to AG 4.08 Attachment 1 indicated that $570,000 of expenses was recorded in the Company's operating expense, $292,000 of which was removed by the Company, as shown on ComEd's WPC-1c, and $278,000 was included in ComEd's revenue requirement, on a total company basis, before jurisdictional allocation.

Other stock awards and executive perquisites in the amount of $227,000 ($203,000 jurisdictional) that were not already removed by ComEd should be removed from ComEd's operating expense. Additionally the capitalized amount of $51,000 ($40,000 jurisdictional) should be removed from ComEd's proposed rate base, as shown on CUB Ex.1.2 Schedule B-4. These stock awards and other perquisites include amounts allocated from affiliates and are beyond the amounts provided for in the annual incentive plans.

Q. Are the 2010 retention awards a reasonably normal and recurring expense for ComEd?

A. No. The 2010 expense for retention awards is related to an isolated event that originated in 2007, as explained in ComEd's response to AG 7.09(b):

> Awards typically are paid upon vesting, three to four years after the agreements are made. The significant increase for 2010 was an isolated event for the payment of a significant group of awards that originated in 2007 in light of the organizational and regulatory transition in 2007 which increased retention concerns, and were expensed and paid in 2010. Awards are now typically granted annually during an Exelon-wide process to review high performing high potential talent with critical skills that are transferrable to other utilities and industries.

Consequently, it is not reasonable to include that expense in the development of ComEd's inception rates under the Formula Rate Plan.

Q. Please explain the adjustment for retention awards.

A. ComEd's response to AG 4.08 shows that in 2010, it recorded $4.28 million for retention awards.[5] ComEd's response to AG 4.08 also provides comparable amounts for the previous three years. The $4.28 million in 2010 significantly exceeded the combined total for the previous three years, which amounted to $2.621 million. This abnormally high level of cost for retention bonuses occurred in 2010, a year with a severe recession and high unemployment. The purpose of the Exelon Retention Policy is retention of key talent to ensure mission critical positions are appropriately staffed in order to achieve the Company's vision. Page 1 of the Retention Policy also provides, among other things, that: "Management retains the right, at all times and in its sole discretion, to modify or revoke this

[5] $1.793 million expensed and $427,000 charged to capital and other accounts for jurisdictional allocation.

Policy [of paying Retention bonuses] at any time, for any reason."[6] While it may be reasonable to include some normal amount of expense for retaining key employees in mission critical positions, the 2010 amount is excessive in comparison to previous years. Also, one must question how the other normal forms of employee compensation (such as wages and benefits) would not be adequate to retain personnel, especially during a period of high unemployment. Consequently, I recommend limiting the 2010 allowance for retention bonuses to a normalized amount, based on a four-year average. This provides for a normalized annual allowance of $1.725 million. ComEd's proposed expense amount of $4.28 million is reduced by $2.01 million ($1.793 jurisdictional) as shown on CUB Ex 1.2, Schedule C-1. Rate base is reduced by $545,000 ($427,000 jurisdictional), as shown on CUB Ex. 1.2, Schedule B-4, for the capitalized portion.

Q. Please explain the adjustment for the performance award expense.

A. The performance award expense should be reduced by $149,000 (or $132,000 on a jurisdictional basis, as shown on CUB Ex. 1.2 Schedule C-1) and rate base should be reduced by $32,000 ($25,000 jurisdictional) as shown on CUB Exhibit 1.2, Schedule B-4, to reflect 50/50 sharing of performance based awards cost in the 2010 test year. The Exelon "Reward and Recognition Policy" is designed to reward significant employee contributions to Exelon's success. The policy

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[6] See, e.g., AG 6.15, Attachment 1, from Docket No. 10-0647, ComEd's last rate case. A copy of ComEd's response to AG 6.15 including attachments is attached to my testimony in AG Exhibit 1.3.

document indicates that the programs are benchmarked and aligned with best practices. Similar to the Retention Policy, the Reward and Recognition Policy also provides, among other things, that "Management retains the right, at all times, and in its sole discretion, to modify or revoke this policy at any time, for any reason." The awards under this policy include cash awards ranging from $1,000 to $5,000; non-cash gift certificate awards ranging from $25 to $500; other non-cash spot awards below $25 per award, such as cafeteria meal vouchers, $5 Subway Restaurant cards, $5 Gas Station cards, movie tickets, etc.; and merchandise awards having a value of $100 or less.[7] Given the nature of this program, I recommend 50/50 sharing of the cost of such "performance based" awards cost in the 2010 test year.

C-2, Restricted Stock Expense

Q. Please discuss the Restricted Stock Program.

A. ComEd's response to IIEC 2.08, Attachment 2 in Docket No. 10-0467, contains the following description in the 2010 Key Manager Restricted Stock Award Program Summary:

> **Program Objectives**
>
> The 2010 Key Manager Restricted Stock Award Program (the "Program") provides restricted stock units ("Restricted Stock") to individuals in select positions who play key roles in supporting Exelon's financial and operational success and whose retention is

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[7] See, e.g., AG 6.15, Attachment 3 (apparently mis-labeled as Attachment 1 in that response) from Docket No. 10-0647, ComEd's last rate case..

> critical to long-term succession. This long-term incentive ("LTI") program is an important component of Exelon's total compensation package for key managers, which is benchmarked and aligned with the best practices of high-performing energy services companies and general industry firms.
>
> **Eligibility**
>
> Directors and managers ("Key Managers") and select other employees are eligible to be considered for awards under the Program.

Directors and managers and select other employees are eligible to be considered for awards under the Restricted Stock Award Program.

Awards under the program are generally paid in shares of Exelon stock, and earn dividend equivalents, as described in ComEd's response to IIEC 2.08, Attachment 2, from Docket No. 10-0467:

> Generally, awards issued under the Program are paid in shares of Exelon common stock and vest incrementally over three years, subject to your continued employment. One-third of your award will vest on the date the Compensation Committee holds its first meeting (usually in January) in each of 2011, 2012 and 2013. Restricted Stock will earn dividend equivalents while vesting, which will be reinvested in additional shares and payable upon vesting. Upon vesting, you will receive payment in shares, net of tax withholding.

Q. What does Exelon's Form 10-K state with respect to Exelon stock awards?

A. Exelon Corporation's 2010 Form 10-K, at page 366, contains the following description of Exelon stock awards:

> Stock awards consist primarily of performance share awards pursuant to the terms of the 2006 Long-Term Incentive Plan. The compensation committee established a performance share unit award program based on total shareholder return for Exelon as compared to the companies in the Standard & Poor's 500 Index and the Dow Jones Utility Index for a three-year period. The threshold, target and distinguished goals for performance unit share awards are established on the grant date (generally the date of the first compensation committee meeting in the fiscal year). The actual performance against

> the goals and the number of performance unit share awards are established on the award date (generally the date of the first compensation committee meeting after the completion of the fiscal year). Upon retirement or involuntary termination without cause, earned but non-vested shares are eligible for accelerated vesting. **The form of payment provides for payment in Exelon common stock to executives with lower levels of stock ownership, with increasing portions of the payments being made in cash as executives' stock ownership levels increase in excess of the ownership guidelines.** If an executive achieves 125% or more of the applicable ownership target, performance shares will be paid half in cash and half in stock. If executive vice presidents and above achieve 200% or more of their applicable stock ownership target, their performance shares will be paid entirely in cash. **In limited cases, the compensation committee has determined that it is necessary to grant restricted shares of Exelon common stock or restricted stock units to executives as a means to recruit and retain talent. They may be used for new hires to offset annual or long-term incentives that are forfeited from a previous employer. They are also used as a retention vehicle and are subject to forfeiture if the executive voluntarily terminates, and in some cases may incorporate performance criteria as well as time-based vesting. When awarded, restricted stock or stock units are earned by continuing employment for a pre-determined period of time or, in some instances, after certain performance requirements are met.** In some cases, the award may vest ratably over a period; in other cases, it vests in full at one or more pre-determined dates. Amounts of restricted shares held by each NEO, if any, are shown in the footnotes to the Outstanding Equity Table.

(Emphasis supplied.)

Q. Should stock-based compensation expense be charged to ratepayers?

A. No, it should not. The cost of the Restricted Stock incentive compensation program is incurred to improve the ComEd and Exelon financial performance for the benefit of shareholders. The objectives of maximizing shareholder value on the one hand, and minimizing costs to ratepayers on the other, are generally opposed to each other. The Restricted Stock incentive expense requested by ComEd should be removed from test year operating expenses. As shown on CUB Exhibit 1.2, Schedule C-2, the removal of Restricted Stock Expense reduces jurisdictional test year expense by $1.921 million.

Q. Were costs associated with the Restricted Sock Expense allowed in the Company's last rate case?

A. These costs were disallowed in Docket No. 10-0467. The Commission recognized that the purpose of the plan is to further the financial and operational success of Exelon, and stated that "incentiviz[ing] management" is not a ratepayer benefit such that the cost may be recovered from ratepayers. The Commission disallowed 100% of this cost. (See ICC Docket No. 10-0467 Final Order at 65)

C-3, Legal Fees Related to IRS Dispute-Sale of Fossil Generating Units

Q. Please explain the adjustment for Legal Fees related to IRS Dispute-Sale of Fossil Generating Units.

A. As shown on CUB Ex.1.2, Schedule C-3, this adjustment removes the legal cost related to an IRS dispute associated with the gain on the sale of the fossil generating units included in ComEd's 2010 operating expense of $776,324.

Q. Was this expense included mistakenly by ComEd in its formula rate plan filing?

A. Yes. The Company's response to CUB 2.05 states:

> The 2010 legal fees related to the IRS Dispute total $776,324 in GL Account 515000, FERC Account 923. Inclusion of these fees was inadvertent oversight and ComEd will remove these costs in its rebuttal filing.

Q. Were the Legal Fees Related to IRS Dispute -Sale of Fossil Generating Units also removed from ComEd's proposed revenue requirement in Docket No. 10-0467?

A. Yes. As stated in the final Order in Docket No. 10-0467, page 110, the amount of legal fees related to IRS dispute- sale of fossil generating units was removed. Removal of this expense from the formula rate plan revenue requirement is therefore also consistent with the Commission's final Order in Docket No. 10-0467.

C-4, Remove Photovoltaic Pilot Costs

Q. Please explain the adjustment to remove Photovoltaic Pilot Costs.

A. As shown on CUB Ex.1.2, Schedule C-4, removal of the Photovoltaic Pilot Costs reduces ComEd's proposed operating expense by $580,000. These costs should be removed from formula rate plan expenses because these costs are not related to the ongoing provision of electric distribution service and were removed in ComEd's last rate case, Docket No. 10-0467. Staff witness Tolsdorf's Rebuttal

Testimony in Docket No. 10-0467, discussed this, noting, among other things, that the Pilot was cancelled, as notified by ComEd on November 15, 2010.

Q. Were the Photovoltaic Pilot Costs included by ComEd in its formula rate plan filing?

A. Yes. ComEd's response to CUB 2.08 listed 2010 Photovoltaic Pilot Costs of $580,154. ComEd's response to AG 1.06 states that "ComEd has made no adjustment to remove these costs."

Q. Were the Photovoltaic Pilot Costs removed from ComEd's proposed operating expense in Docket No. 10-0467?

A. Yes. The final Order in Docket No. 10-0467, page 119 states:

> "The Commission approves Staff's proposal (to remove this expense)."

Removing this expense from ComEd's proposed formula rate plan operating expense is consistent with the Commission's final Order in Docket No. 10-0467.

C-5, Depreciation Expense Adjustment from G&I Reallocation

Q. Please explain the adjustment for General and Intangible plant depreciation expense shown on CUB Ex.1.2 Schedule C-5.

A. This adjustment reduces the depreciation expense by $497,000 to remove the impact from the G&I allocation methodology change proposed by ComEd.

Similar to the Commission's rejection of the cost allocation methodology change that ComEd had proposed in Docket No. 10-0467, the allocation methodology change proposed by ComEd in its formula rate plan filing is without merit and increases the jurisdictional revenue requirement, and should also be rejected. The related rate base adjustment for G&I reallocation is shown on CUB Ex 1.2, Schedule B-3.

C-6, Adjustment for Three Years of Illinois Distribution Tax Credits Recorded in 2010

Q. Please explain the adjustment shown on CUB Ex.1.2, Schedule C-6.

A. This adjustment reduces ComEd's proposed amortization expense by $5.197 million to reflect normalization over three years for the three years of Illinois Tax Credits that ComEd recorded in 2010.

Q. What does ComEd Propose in its current Formula Rate Plan Filing for the Three Years of Illinois Electric Distribution Tax ("IEDT") Credits Recorded in 2010?

A. ComEd's response to IIEC 2.07 states that ComEd amortized the additional IEDT credit it recorded for accounting purposes in 2010 over five years and included the unamortized balance in its rate base.

Q. How does the Company attempt to justify its treatment for the Three Years of IEDT Credits Recorded in 2010?

A. ComEd's response to IIEC 2.07 states:

> [I]n accordance with Section 16-108.5(c)(4)(f) of the act, ComEd amortized the additional IEDT credit it recorded for accounting purposes in 2010 and the June 2010 storm expense over five years and included the unamortized balance of each in its rate base.

Q. That response mentions a June 2010 storm expense as well as the IEDT credit. Do you agree with ComEd's proposed treatment of the June 2010 storm expense?

A. Yes. ComEd's proposed five-year amortization of the June 2010 storm expense is provided for in Section 16-108.5(c)(4)(f) of the act.

Q. Do you agree with ComEd's amortization over five years for proposed IEDT ComEd recorded in 2010?

A. No. There is no requirement in Section 16-108.5(c)(4)(f) to normalize Illinois Distribution Tax Credits over five years, and is makes more sense to normalize the three years of IEDT that ComEd recorded in 2010 over three years, to match the normalization result with the number of years of IEDT periods.

Section 16-108.5 (c)(4)(f) states:

> amortization over a 5-year period of the full amount of each charge or credit that exceeds $3,700,000 for a participating utility that is a combination utility or $10,000,000 for a participating utility that serves more than 3 million retail customers in the applicable calendar year and that relates to a workforce reduction program's severance costs, changes in accounting rules, changes in law, compliance with any Commission-initiated audit, or a single storm or other

> similar expense, provided that any unamortized balance shall be reflected in rate base.

The three years of Illinois Distribution Tax Credits that ComEd recorded in 2010 do not relate to either (1) workforce reduction program's severance costs, (2) changes in accounting rules, (3) changes in law, (4) compliance with any Commission-initiated audit, or (5) a single storm or other similar expense. Section 16-108.5(c)(4)(f) therefore does not apply to the IEDT and does not mandate a five-year normalization for three years of IEDT credit. Since the IEDT amounts recorded by ComEd in 2010 are for three years of IEDT credit (i.e. IEDT credit for years 2008, 2009, and 2010), this should be normalized over three years, not over 5 years. The $5.197 million of amortization expense adjustment is the difference between the 5-year and 3-year amortization.

C-7, Interest Synchronization

Q. Please explain the adjustment for interest synchronization.

A. As shown on CUB Ex. 1.2, Schedule C-7, the interest synchronization adjustment synchronizes the rate base and cost of capital with the tax calculation. It is calculated by applying the weighted cost of debt to the adjusted jurisdictional rate base to obtain a synchronized interest deduction for use in the calculation of test year income tax expense. As shown on Schedule C-7, the weighted cost of debt, which is 3.54 percent (from Schedule D), has been applied to the adjusted rate base amount in order to determine the pro forma interest deduction to be used in calculating income tax expense for the test period. The state and federal income tax rates of 7.30 percent and 35 percent are then applied to the resulting interest deduction difference to determine the amount of adjustment to income tax expense for interest synchronization.

C-8, ComEd Annual Incentive Compensation

Q. Please explain the adjustment shown on CUB Ex.1.2 Schedule C-8, for ComEd's Annual Incentive Compensation.

A. As shown on CUB Ex. 1.2, Schedule C-8, ComEd's 2010 annual incentive compensation expense is reduced by $2.248 million on a jurisdictional basis to limit the amount included to a maximum of 100 percent of the targeted awards amount.

Q. How does the Act provide for limiting the recovery of incentive compensation expense?

A. The Act at Section 16-108.5(c)(4)(A) provides, subject to a determination of prudence and reasonableness consistent with Commission practice and law, for the following:

> [R]ecovery of incentive compensation expense that is based on the achievement of operational metrics, including metrics related to budget controls, outage duration and frequency, safety, customer service, efficiency and productivity, and environmental compliance. Incentive compensation that is based on net income or an affiliate's earnings per share shall not be recoverable under the performance-based formula rate.

In summary, the incentive compensation must be reasonable and consistent with Commission practice. Additionally, nothing in Section 16-108.5(c)(4)(A) justifies charging ratepayers for additional incentive compensation increases that result from unilateral decisions by Company management to significantly increase the otherwise applicable Net Income Limiter features of the incentive compensation plan that would have limited the 2010 payouts.

Q. Is limiting incentive compensation that is related to achievement of operational metrics, including metrics related to budget controls, outage duration and frequency, safety, customer service, efficiency and productivity, and environmental compliance to 100 percent of the plan target reasonable and consistent with Commission practice?

A. Yes, it is. As admitted in ComEd's response to TEE 6.05, in fact, ComEd's own prior practice was to request recovery of incentive compensation at target levels. The Commission practice, likewise, appears to be to limit the ratemaking inclusion of utility incentive compensation to a maximum of 100 percent of plant target amounts. The formula rate plan does not provide a reason for charging ratepayers for additional incentive compensation amounts that are not reasonable and are not consistent with Commission practice. It is not reasonable to charge ratepayers for incentive compensation that exceeds 100 percent of the target. Moreover, ComEd's Exhibit 4.9, at page 18, states that compensation above target is not recoverable in rates. That ComEd statement appears to accurately reflect and be consistent with Commission practice. Consequently, amounts over 100 percent of target for incentive compensation are not reasonable and are not consistent with Commission practice for such cost, and should not be borne by ratepayers under the formula rate plan. Limiting the allowance for ComEd incentive compensation to 100 percent of target reduces jurisdictional expense by $2.248 million, as shown on CUB Ex. 1.2, Schedule C-8.

Q. Please explain the other calculations shown on CUB Ex. 1.2, Schedule C-8.

A. CUB Ex. 1.2, Schedule C-8 also shows a calculation of the adjustment to 2010 jurisdictional operating expenses that would be necessary to decrease the amount of ComEd's annual incentive compensation from the 112.1 percent to 102.9 percent to remove the additional expense for 2010 caused by applying the plan's CEO Discretionary Feature. As described in the response to AG 1.13, and Attachment 1 to that response, annual incentive plan results for 2010 were to be limited to a maximum of 102.9 percent based on the application of the plan's net income limiter. However, ComEd's leadership recommended that the net income limiter be adjusted from 102.9 percent to 112.9 percent. This resulted in increasing the ultimate payout to 112.1 percent as shown in the Company's response to AG 1.13. As explained in ComEd's response to AG 4.10(c):

> "[T]he CEO Discretionary Feature is at management's sole discretion, based on business conditions and subject to approval by the board."

As explained in the response to AG 4.10(e):

> "[T]he purpose of the Net Income Limiter is to ensure that the payouts above target are aligned with ComEd's financial performance, which has the effect of capping

> overall AIP payouts, which protects both shareholders and ratepayers."

As explained further in ComEd's response to AG 4.10(f):

> The Net Income Limiter amounts were set using ComEd's 2010 Budget Operating Net Income. The performance scale started equal to the 2010 Budget at the 50% payout limit level and, with management discretion, a scale of roughly 5% increases were set for each subsequent tier of payout limits.

The additional expense that resulted from this CEO Discretionary Feature to bust the otherwise applicable 2010 net income limiter provision should therefore be allocated solely to shareholders, and should not be borne by ComEd ratepayers. It is unreasonable for ratepayers to pay additional expense for incentive compensation based on CEO discretion to increase the limitation otherwise provided by the net income limiter. The extra annual incentive compensation expense should be borne by shareholders and not by ratepayers.

C-9, Exelon Business Services Affiliated Incentive Compensation Expense Charged to ComEd

Q. Please explain the adjustment for Annual Incentive Compensation based on earnings that was charged to ComEd from the affiliate, Exelon Business Services.

A. As shown on CUB Ex. 1.2, Schedule C-9, incentive compensation expense that was charged to ComEd by the affiliate, Exelon Business Services (BSC), that is tied to earnings-per-share goals should be excluded from operating expenses.

ComEd's response to AG 6.08(g) shows that ComEd included as jurisdictional operating expenses $5.651 million of BSC charges for annual incentive compensation to ComEd. That amount consists of $2.563 million BSC direct-billed charges and $3.088 million indirect BSC charges.[8] ComEd's response to AG 6.08(e) admits that:

> For BSC, 75% of the AIP is tied to the EPS goal and 25% is tied to meeting the BSC total cost goal, which is established based on business planning guidance for the year.

The portion of BSC incentive compensation charges to ComEd that is based on the earnings-per-share goal should be removed from ComEd's operating expenses, consistent with the guidance of Section 16-108.5(c)(4)(A), which clearly provides that "[i]ncentive compensation that is based on net income or an affiliate's earnings per share shall not be recoverable under the performance-based formula rate."

Consequently, as shown on CUB Ex. 1.2, Schedule C-9, $3.789 million of incentive compensation expense that was charged to ComEd by the affiliate, Exelon Business Services (BSC) that is tied to earnings-per-share goals must be excluded from ComEd's operating expenses for purposes of determining the formula rate.

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[8] According to ComEd's response to AG 6.08(g), the BSC indirect charges amount is net of AIP amounts removed in line 20 of ComEd Ex. 4.2, APP 7.

C-10, Carrying Cost on SERP ADIT as Part of Net Pension Carrying Costs

Q. Please explain the adjustment to expense shown on CUB Ex. 1.2, Schedule C-10?

A. As shown on CUB Ex. 1.2, Schedule C-10, expense is increased by $323,000 by applying the 6.37 cost rate to the $5.067 million SERP ADIT from CUB rate base adjustment B-12.

C-12, Use Jurisdictional Allocation for Property Tax Expense Based on Same Methodology Used in Docket No. 10-0467

Q. Please explain the adjustment for property taxes shown on CUB Ex. 1.2, Schedule C-12.

A. Per ComEd's responses to CUB 2.07 and CUB 3.01, ComEd used a 78.42 percent jurisdictional allocation, which is inconsistent with the jurisdictional allocation methodology for property taxes that was used in Docket No. 10-0467. Per ComEd's response to CUB 3.01, the jurisdictional allocation for property taxes that was used in Docket No. 10-0467 produces an allocation factor of 61.11 percent, jurisdictional property taxes of $11.808 million, and an adjustment of $3.345 million. ComEd's response to CUB 3.02 provides the Company's explanation of why it has proposed a different jurisdictional allocation methodology that is inconsistent with the method used in Docket No. 10-0467; however, that Company explanation is unconvincing and does not justify a change that would substantially shift additional cost into jurisdictional expenses for property taxes. ComEd's proposed jurisdictional allocation of property taxes should be reduced by $3.345 million, consistent with the jurisdictional allocation method and findings of Docket No. 10-0467.

VII. CALCULATION FOR ANNUAL RECONCILIATIONS

Use of Average Calendar Year Rate Base for Annual Reconciliations

Q. What does the Act prescribe for an annual reconciliation filing?

A. Section 16-108.5(c)(6) provides for an annual reconciliation between the revenue requirement determined pursuant to the formula rate and the revenue requirement that would have been determined if actual cost information from the applicable calendar year had been available at the filing date. Specifically, Section 16-108.5(c)(6) states as follows:

> Provide for an annual reconciliation, with interest as described in subsection (d) of this Section, of the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date.

The reference to "what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date" suggests the use of an average rate base methodology for measuring ComEd's actual results under the reconciliation. Actual cost information for the applicable calendar year would include additions and subtractions from the jurisdictional rate base as they have occurred throughout the year. Section 16-108.5(c)(6) specifically says “applicable calendar year” and a calendar year is a 12-month period starting on January 1 and ending on December 31. For rate base, the calendar year is this period and should thus reflect actual additions and retirements that have occurred during the year. If the legislature had intended a year-end rate base, presumably the specification would have been for a “calendar year-end” and not for the “applicable calendar year.”

Q. In measuring ComEd’s earnings for the reconciliation phase of the formula rate plan, what has ComEd proposed for the determination of jurisdictional rate base?

A. ComEd appears to be proposing that a year-end rate base be used for the purpose of measuring actual results achieved during the year for the reconciliation calculation. The use of a year-end rate base to measure actual results is a mis-match, with the requirement of Section 16-108.5(c)(6) that the reconciliation consider "what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date." If ComEd’s jurisdictional rate base has grown during the measurement period, it could cause a significant distortion to the measurement of ComEd’s earnings.

Q. How has ComEd proposed to compute rate base for purposes of the annual reconciliation filing?

A. ComEd's Ex. 4.1, Schedule FR A-1 REC, appears to show the Company's proposed calculation. Line 12 of that schedule references Schedule FR B-1, line 49, for the rate base for the reconciliation. ComEd Ex. 4.1, Schedule FR B-1, shows a rate base calculation that is premised largely upon the use of end-of-calendar-year rate base amounts.

Q. Does the Act specify whether an average year or year-end rate base should be utilized for purposes of making the reconciliation calculation under the formula rate plan?

A. Whether an average year or year-end rate base should be utilized for purposes of making the true-up calculation under the formula rate plan would appear to require an interpretation of the term "applicable calendar year" from Section 16-108.5(c)(6). ComEd has apparently interpreted this to mean calendar-year end, and to focus on December 31 cost information, which is contrary to the plain meaning of "calendar year," which is a 12-month period starting on January 1 and ending on December 31.

Q. Hasn't a year-end rate base been used in ComEd's base rate cases?

A. Yes, however, the purpose of a base rate case is to set rates prospectively. Additionally, the rates established in a base rate case proceeding would typically be expected to be in effect for more than one year. On the other hand, the purpose of the reconciliation aspect of the formula rate plan is to measure the utility's actual earnings during that single 12-month calendar year period. Thus, the attrition related aspect of determining rate base in a base rate proceeding that involves the use of year-end, rather than average test year rate base, is not applicable in the context of the formula rate plan reconciliation, and in fact, would distort the measurement of plan results for that year, by measuring actual revenue and expenses against an end-of-year rate base.

Q. Can you please provide a simple example of how a year-end rate base would distort the reconciliation compared to the use of actual cost information for the calendar year, on average?

A. Yes. The following simple illustration assumes that the utility had jurisdictional rate base investment of $6.5 billion on January 1 and $6.7 billion on December 31 of the calendar year, that the investment had been added ratably during the calendar year, and that the amount of actual net operating income for the year was approximately $540 million:

Simplified Comparison of Year-End and Average Calendar Rate Base-Illustrative Example
(Thousand of Dollars)

Line No.	Description	December 31 (Calendar Year-End) Rate Base	Average Rate Base for Applicable Calendar Year	Difference
		(A)	(B)	(C)
1	Jurisdictional Rate Base	$ 6,740,000	$ 6,620,000	$ 120,000
2	Required Reutrn	8.12%	8.12%	
3	Operating Income Required	$ 547,288	$ 537,544	$ 9,744
4	Net Operating Income Available	$ 540,000	$ 540,000	$ -
5	Operating Income Deficiency (Excess)	$ 7,288	$ (2,456)	$ 9,744
6	Gross Revenue Conversion Factor	1.6596	1.6596	
7	Revenue Deficiency (Sufficiency)	$ 12,095	$ (4,076)	$ 16,171

As shown in the simplified illustrative example, the difference between using a year-end rate base and the average rate base for the applicable calendar year can have a significant impact on the results. Where the utility's rate base is growing significantly, the distortion in the measurement of results for the applicable calendar period can become quite large.

Q. Does proper matching in the formula rate plan true-up dictate that an average rate base for the reconciliation year be used?

A. Yes. For purposes of measuring the utility's earnings for the one-year period for purposes of the formula rate plan true-up feature, an average rate base concept should be used. This is necessary for proper matching of the measurement information.

Q. Should ComEd be ordered to compute the rate base for the true-up phase using an average test year rate base concept?

A. ComEd's proposed schedules for the true-up phase of the formula rate plan measurement should be revised to conform with the concept of using an average rate base to measure earnings for the true-up phase.

Carrying Cost for Under- or Over-Collected Balances

Q. How does the Act provide for carrying costs on over- or under-collected balances resulting from the annual reconciliations?

A. Section 16-108.5(d)(1) states that:

> Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest, the charges for the applicable rate year.

Thus, the Act provides for interest to be applied, but does not specify how the interest rate should be determined or whether a different interest rate should be applied to over- and under-collections.

Q. What interest rate for over- and under-collections has ComEd proposed in its filing?

A. ComEd's Ex. 4.1, Schedule FR A-4, shows the Company's proposed calculation, which involves applying a monthly interest rate of 0.6842 percent to one-twelfth of the annual amount of reconciliation variance before interest. The 0.6842 percent is apparently based upon one-twelfth of ComEd's proposed weighted cost of capital of 8.21 percent (which included a 10.25 percent ROE).

Q. What carrying cost, or interest rate, do you recommend be applied on under- and over-collected balances?

A. Carrying costs on over-collections by ComEd should be computed at the larger of (1) ComEd's overall cost of capital or (2) ComEd's short term debt cost. Carrying costs on under-collections by ComEd should be computed at the smaller of (1) ComEd's overall cost of capital or (2) ComEd's short term debt cost.

Q. Why should a different rate be applied to under- and over-collections?

A. This is necessary in order to protect ratepayers from manipulation of the projected plant addition amounts by ComEd. ComEd will be responsible for developing the amount of its projected plant additions for each year and could thus produce over-collections simply by over-projecting such plant additions. Requiring a higher interest rate for over-collections will thus provide an appropriate and necessary deterrent to ComEd that will discourage the Company from making intentional over-projections of plant additions. Additionally, allowing interest on under-collections based on the lesser of the short-term debt cost rate and ComEd's overall weighted cost of capital, will also encourage the Company to make accurate projections of plant additions, because its earnings on under-collected balances resulting from mis-projecting plant additions would be at the lower of those rates.

Q. Does that conclude your direct testimony?

A. Yes, it does.