

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)
)
Tariffs and charges submitted pursuant to) Docket No. 11-0721
Section 16-108.5 of the Public Utilities Act)

DIRECT TESTIMONY OF MICHAEL L. BROSCH
ON BEHALF OF THE
PEOPLE OF THE STATE OF ILLINOIS AND AARP

PUBLIC AND REDACTED

DATED JANUARY 13, 2012

AG-AARP

OFFICIAL FILE

I.C.C. DOCKET NO. 11-0721

~~Prosch~~ Exhibit No. 1.0 Public

Witness Brosch

Date 3/2/12 Reporter _____

DIRECT TESTIMONY OF MICHAEL L. BROSCHE

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EXHIBIT LIST

- AG/AARP Exhibit No. -1.1 Summary of Qualifications
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- AG/AARP Exhibit No. -1.4 ComEd’s Response to RMP 1.01 (Confidential)
- AG/AARP Exhibit No. -1.5 ComEd’s Response to AG 1.06
- AG/AARP Exhibit No. -1.6 ComEd’s Responses to AG 1.29, AG 1.30, DGK 1.10 and DGK 1.11.
- AG/AARP Exhibit No. -1.7 ComEd’s Responses to AG 7.02 and AG 4.25
- AG/AARP Exhibit No. -1.8 ComEd’s Response to AG 7.06
- AG/AARP Exhibit No. -1.9 ComEd’s Response to AG 1.27
- AG/AARP Exhibit No. -1.10 ComEd’s Responses to PR 1.02, CUB 3.01, CUB 3.02 and AG 4.05.
- AG/AARP Exhibit No. -1.11 ComEd’s Responses to AG 4.08 and AG 1.15

I. INTRODUCTION / SUMMARY

1 **Q. Please state your name and business address.**

2 A. My name is Michael L. Brosch. My business address is PO Box 481934, Kansas
3 City, Missouri 64148-1934.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in
7 utility rate and regulation work. The firm's business and my responsibilities are
8 related to regulatory projects for utility regulation clients. These services include
9 rate case reviews, cost of service analyses, jurisdictional and class cost allocations,
10 financial studies, rate design analyses, utility reorganization analyses and focused
11 investigations related to utility operations and ratemaking issues.

12 **Q. On whose behalf are you appearing in this proceeding?**

13 A. I am appearing on behalf of the People of the State of Illinois represented by the
14 Attorney General, ("Attorney General" or "AG") and AARP (formerly the
15 American Association of Retired Persons).

16 **Q. Will you summarize your educational background and professional experience
17 in the field of utility regulation?**

18 A. Yes. AG/AARP Exhibit No. 1.1 is a summary of my education and professional
19 qualifications. I have testified before utility regulatory agencies in Arizona,
20 Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan,
21 Missouri, New Mexico, Ohio, Oklahoma, Texas, Utah, Washington, and Wisconsin
22 in regulatory proceedings involving electric, gas, telephone, water, sewer, transit,
23 and steam utilities. A listing of my previous testimonies in utility regulatory

24 proceedings is set forth in AG/AARP Exhibit No. 1.2. In Illinois, I have testified in
25 several major proceedings before the Illinois Commerce Commission (“the
26 Commission” or “the ICC”). These include Peoples Gas rate cases in Docket Nos.
27 90-0007 and 07-0242, North Shore Gas Company Docket No. 07-0241, Illinois Bell
28 Telephone Company in Docket Nos. 92-0448 and 92-0239, ComEd rate case
29 Docket Nos. 07-0566 and 10-0467 and Ameren Illinois Utilities Docket Nos. 07-
30 0585 through 07-0590. I also testified in ComEd Docket No. 09-0263 involving the
31 Advanced Metering Infrastructure Pilot Program and Associated Tariffs and in
32 response to ComEd’s alternative regulation proposal that was filed in Docket No.
33 10-0527.

34 **Q. What is the purpose of your testimony in this docket?**

35 A. My testimony is responsive to the formula rate regulatory proposals of
36 Commonwealth Edison Company (“ComEd” or “Company”), in this Docket that
37 are captioned as “Tariffs and charges submitted pursuant to Section 16-108.5 of the
38 Public Utilities Act.” I will describe my understanding of formula rate regulation,
39 as specified in new Section 16-108.5 of the Public Utility Act (“PUA” or “the
40 Act”), and then will discuss why certain of ComEd’s specific proposals for
41 implementation of formula rate regulation in this Docket are not reasonable and
42 should be modified by the Commission in its Order. My testimony addresses the
43 ratemaking concepts and procedures that are being recommended by ComEd as
44 well as specific rate case adjustments that are needed upon implementation of
45 annual formula ratemaking.

46 **Q. Please summarize the recommendations that are set forth in your testimony.**

47 A. My testimony addresses several issues impacting the determination of ComEd's
48 asserted revenue requirement under the proposed formula rate and the subsequent
49 "true-up" of such revenue requirements within annual reconciliation procedures that
50 are proposed in the testimony of Company witnesses Houtsma¹ and Fruehe.² I
51 explain the test year approach employed to develop the annual rate changes
52 pursuant to formula and why it is essential that an average test year be used in the
53 reconciliation procedures for determination of ComEd's final revenue requirement
54 in each future year. My testimony also addresses the interest rate that should be
55 applied to over or under-recoveries of ComEd's revenue requirement when
56 reconciliation calculations are performed. The balance of my testimony then
57 focuses upon and recommends specific ratemaking adjustments to ensure that future
58 formula-based rates are just and reasonable.

59 With regard to Cash Working Capital ("CWC"), I recommend the conduct
60 of additional studies to improve the accuracy of the estimated revenue collection lag
61 and sponsor immediate revisions under ComEd's flawed method now being used to
62 estimate the revenue collection lag, so as to reduce the overstatement of CWC being
63 proposed by the Company. I also propose elimination of ComEd's assignment of a
64 revenue lag associated with Pension and OPEB expenses, where no corresponding
65 expense payment lead has been measured for these costs. ComEd's proposed
66 change in lead/lag calculations that now applies a revenue lag to pass-through tax
67 collections is also discussed and revised in my testimony.

68 I propose several adjustments to test year operating expenses in my
69 testimony, including re-instatement of the disallowance of certain types of expenses

¹ ComEd Ex. 2.0 through 2.1.

70 that have previously been excluded or normalized by prior Commission Order. The
71 expense adjustments I sponsor include disallowance of certain management
72 perquisites, elimination of costs of stock-based compensation and incentive
73 compensation expenses incurred by affiliate companies based upon financial
74 performance, elimination of legal fees associated with non-jurisdiction tax disputes,
75 with provisions for future adjustments for charitable contributions and interest
76 expense associated with the Customer Deposit balances that are reflected within
77 rate base.

78 ComEd has also deviated from the established jurisdictional allocation
79 methods that have been previously approved by the Commission. I explain why
80 these changes should either be rejected by the Commission or, in the alternative,
81 offsetting changes to the revenue crediting of Late Payment Charge revenues to the
82 Federal Energy Regulatory Commission ("FERC") Transmission jurisdiction
83 should be reflected in the Commission's Order.

84 **Q. What information have you relied upon in formulating your**
85 **recommendations?**

86 A. I have relied upon ComEd's pre-filed testimony and exhibits in this Docket, as well
87 as the Company's responses to data requests submitted by Staff, AG, AARP, CUB
88 and other parties. I have also relied upon a copy of Public Act Numbers 97-0616
89 and 97-0646, adding 220 ILCS 5/16-108.5 to the Public Utilities Act, that was
90 provided to me by AG counsel. I also rely upon my prior experience with
91 regulation of public utilities over the past 31 years, including significant experience
92 in Illinois and with alternative forms of regulation for telephone and energy utilities.

² ComEd Ex. 4.0 through 4.10.

93 **Q. Have you prepared any accounting schedules to summarize the adjustments**
94 **being proposed in your testimony and by Mr. Effron?**

95 A. Yes. AG/AARP Exhibit 1.3 is a seven page summary of the revenue requirement
96 revisions being proposed by Mr. Effron and me. The first page of the Exhibit sets
97 forth the Company's asserted formula revenue requirement from ComEd Exhibit
98 4.3, which is premised upon the approved Trailer Bill version of formula
99 ratemaking for participating utilities. Adjustments are then posted in columns to the
100 right of ComEd's asserted values, with supporting calculations appearing on
101 subsequent pages, as referenced in the headings for each column. The sum of Mr.
102 Effron's proposed adjustments is inserted at column (j) on page 1. It should be
103 noted that Mr. Effron and I have not, with available time and resources, been able to
104 conduct a complete review of all aspects of the Company's filing. As a result, the
105 limited adjustments we are proposing should be viewed as cumulative with the
106 work and recommendations of Commission Staff and other parties' witnesses.

107 **Q. ComEd has proposed spreadsheet template forms for calculation of future**
108 **rates and an extensive and detailed new Rate DSPP for Commission review**
109 **and approval in this Docket. Have you examined these documents in sufficient**
110 **detail to propose all conforming adjustments that may be needed in connection**
111 **with your ratemaking adjustments and proposals?**

112 A. No. I have attempted to reference in my testimony the individual formula rate
113 schedules where relevant calculations appear that would require modification upon
114 Commission acceptance of my ratemaking proposals. However, I have not
115 prepared a complete set of formula rate template revisions to address all of the
116 issues that may be raised in these proceedings. I have also been unable with

117 available time and resources to propose comprehensive edits to the 171 pages of
118 proposed Rate DSPP. Under these circumstances, I recommend that the
119 Commission include in its order in this docket a requirement that ComEd submit
120 conforming changes to ComEd Ex. 2.0 (formula template) and ComEd Ex. 9.1
121 (Rate DSPP tariff) after the many issues raised in this proceeding have been
122 resolved.

123

124

II. TEST YEAR PRINCIPLES.

125 **Q. What is the purpose of a “test year” in the determination of public utility**
126 **revenue requirements?**

127 A. Energy utilities have traditionally been regulated based upon their cost to provide
128 service, including an opportunity to earn a reasonable return on invested capital.
129 The process used to evaluate and measure the cost of service and resulting revenue
130 requirement is the rate case, in which a balanced review of jurisdictional expenses,
131 rate base investment, the cost of capital and revenues at present rates can be
132 undertaken at a common period in time, referred to as a “test year.” The proper
133 selection and consistent application of the test year is critically important, so that all
134 of the components of the revenue requirement, including rate base, operating
135 expenses, capital costs and sales or billing determinants are holistically analyzed
136 and quantified in a balanced and internally consistent manner with appropriate
137 “matching” of costs and revenues.

138 **Q. Are there several commonly employed types of rate case test years?**

139 A. Yes. The two broad categories of test years include “historical” test years that
140 employ actual recorded financial information to develop the revenue requirement

141 and “future” and “forecasted” test years that employ projections of expected future
142 financial information to develop the revenue requirement. Within these two broad
143 categories, the test year calculations can be based upon either an “average” set of
144 rate base and income data throughout the 12 months of the year or, alternatively, an
145 “end-of-period” or “annualized” approach that adjusts one or more elements of the
146 revenue requirement calculation to cost and revenue levels extant at year-end.

147 **Q. What type of test year has been proposed by ComEd in the determination of its**
148 **asserted first year formula rate-based revenue requirement?**

149 A. The Company’s proposed test year is a hybrid, employing both historical and
150 forecasted information and both average and year-end information, as more fully
151 explained in the Direct Testimony of Mr. Martin Fruehe.³ The Company’s
152 proposed rate base is measured as of December 31, 2010, and then is increased for
153 projected plant additions and for projected growth in Accumulated Depreciation
154 through December 31, 2011.⁴ The Company has generally quantified the individual
155 elements of rate base as of test year-end, except for CWC which is quantified by
156 lead/lag study and the Materials & Supplies and Customer Deposits balances, which
157 are quantified as a 13-month average.⁵ Thus, for Rate Base, ComEd proposes use
158 of both historical and projected data and both average and year-end quantification
159 of specific Rate Base elements.

160 ComEd’s test year Operating Income for ratemaking purposes is based
161 generally upon historical, average amounts as recorded in calendar 2010. Operating
162 expenses and Depreciation/Amortization expenses start at recorded calendar year

³ ComEd Ex. 4.0, pp. 11-19.

⁴ Id., p. 12.

163 levels, with certain adjustments to account for cost recoveries through other tariff
164 mechanisms or to exclude costs not allowable for ratemaking purposes.⁶
165 Exceptions to this historical, average approach include projections of depreciation
166 expense associated with ComEd's projected Plant in Service additions and for
167 Income Tax expenses that are calculated applying statutory tax rates to a calculation
168 of ratemaking taxable income.⁷ Rather than calculating revenues at present rates for
169 comparison to the asserted revenue requirement, ComEd is proposing that its
170 overall test year revenue requirement be divided through annual billing
171 determinants, so as to set revised tariff prices and the billing determinants that are
172 based upon average 2010 customer bill counts and calendar 2010 weather
173 normalized sales volumes.⁸

174 **Q. Will the revenue requirement and new rates resulting from ComEd's initial**
175 **installment of annual formula rate changes later be subjected to reconciliation**
176 **and "true-up" provisions under Section 16-108.5?**

177 **A.** Yes. Each May 1, ComEd proposes to file its calculation of prospective changes to
178 the formula rate revenue requirement using inputs from the prior year's FERC Form
179 1 and other data sources. As part of this filing, ComEd would then also calculate a
180 reconciliation to "true-up" the previously approved revenue requirement, which had
181 incorporated projections of changes in Plant investment, accumulated depreciation
182 and depreciation expense, to determine a revised revenue requirement for the same

⁵ Id., pp. 15-18. See also ComEd Ex. 4.1, Schedule FR B-1 and referenced sources therein and ComEd Ex. 2.0, pp. 13-18.

⁶ ComEd Ex. 2.0, pp. 18-22; ComEd Ex. 2.1, Sch. FR C-1 and FR C-4; ComEd Ex. 4.0, pp. 19-29.

⁷ ComEd Ex. 4.0, pp. 28-29.

⁸ ComEd Ex. 9.0, pp. 5-8.

183 period using then available actual recorded data.⁹ According to ComEd witness Mr.
184 Hemphill, “Importantly, the annual reconciliation proceedings ensure that ComEd
185 recovers no more than its actual costs of service.”¹⁰

186 **Q. Has ComEd proposed any particular test year approach for calculation of the**
187 **reconciliation revenue requirement?**

188 A. There is no discussion of reconciliation test year concepts in the Company’s
189 prepared testimony, but the references appearing in ComEd Ex. 2.1 and ComEd
190 Exhibit 4.1 at Schedule FR A-1-REC¹¹ indicate the Company’s intent to again use a
191 year-end rate base to calculate the reconciliation revenue requirement so as to “true-
192 up” previously approved revenue levels.¹²

193 **Q. Is it appropriate to employ a year-end rate base in calculating the**
194 **reconciliation revenue requirement that would “true-up” costs using actual**
195 **information?**

196 A. No. The reconciliation calculation should employ an average rate base to properly
197 quantify the return on investment elements of the revenue requirement. The proper
198 level of return for investors should reasonably compensate the actual level of capital
199 invested in the Delivery Service business throughout the true-up period. Adoption
200 of ComEd’s proposed reconciliation approach, which would apply the allowed rate
201 of return to year-end rate base, would systematically overstate the true-up rate base

⁹ ComEd Ex. 1.2, pp. 4-6, “Annual Updates to and Reconciliations under Rate DSPP.”

¹⁰ ComEd Ex. 1.0, p. 19:372-373.

¹¹ ComEd Ex. 4.1 and 4.3 both represent calculations of revenue requirements populating the template set forth as ComEd Ex. 2.1 primarily with calendar year 2010 input data, with and without application of what ComEd calls the “Trailer Bill”. The balance of this testimony will reference the ComEd Ex. 4.1 calculations that do not recognize the “Trailer Bill.” This is necessary because ComEd Ex. 4.3 does not include all of the Schedules needed to fully explain the revenue requirement issues discussed herein.

202 and resulting reconciliation revenue requirement. ComEd's investment in assets
203 serving Delivery Service customers is generally higher at year-end than throughout
204 the reconciliation year.

205 **Q. Does ComEd's "election" to be a "Participating Utility" under Section 16-**
206 **108.5, as stated in Mr. Hemphill's testimony,¹³ cause the decision regarding use**
207 **of an average versus year-end rate base in the reconciliation to be an important**
208 **issue?**

209 A. Yes. The Company is committing to making incremental investments in electric
210 system upgrades estimated at \$1.3 billion over five years, plus another estimated
211 \$1.3 billion of incremental investment over ten years in Smart Grid system
212 upgrades.¹⁴ These "incremental" investments totaling \$2.6 billion are above and
213 beyond ComEd's normal pace of spending to accommodate replacement of aging
214 plant, customer growth and other ongoing capital programs. If we assume ratable
215 capital spending and the impact of only the incremental investment commitments in
216 years one through five of the program, annual rate base growth caused by the new
217 investments could eventually represent \$390 million per year.¹⁵ The "value" of
218 reconciling the revenue requirement using year-end versus average rate base would
219 be approximately one-half the ratable investment growth expected each year, since
220 the mid-point of spending in a typical future year could be at the \$195 million level

¹² Schedule FR A-1-REC at line 12 indicates an intended "Source" for the "Rate Base-Reconciliation" value would be Schedule FR B-1 at line 49, which amount is the sum of recorded year-end rate base balances, prior to projected Plant additions for the subsequent year.

¹³ ComEd Ex. 1.0, p. 4.

¹⁴ Id., p. 5:95-107.

¹⁵ Sum of \$1.3 billion / 5 years plus \$1.3 billion / 10 years. ComEd's Infrastructure Investment Plan filed 1/6/2012 in Attachment 2 indicates incremental investment planned in 2012 totaling \$233 million. (See Table A.1)

221 of Plant additions while by year-end Plant additions could total \$390 million.¹⁶
222 Translating this typical rate base difference of \$195 million into revenue
223 requirement would produce additional annual revenues for ComEd after
224 reconciliation of approximately \$25 million per year.¹⁷

225 **Q. Does ComEd, in fact, anticipate significant and continuous growth in its**
226 **ratemaking capital structure in every year of the infrastructure investment**
227 **plan for which it has prepared projections?**

228 A. ~~XXX~~ The Company's confidential response to Staff Data Request No. RMP 1.01 in
229 Attachment 1 provided projections showing ~~XXXXXXXXXXXXXXXXXXXXXXXXXXXX~~
230 ~~XX~~
231 ~~XX~~
232 ~~XX~~ there is no doubt that using a
233 year-end rate base in the reconciliation of annual revenue requirements will
234 overstate charges to customers and inflate the Company's return on actual
235 investment, relative to the actual cost of capital. I have included a copy of this
236 confidential response as AG/AARP Exhibit 1.4 (Confidential).

237 **Q. Can you provide an illustration of how the Company's proposed use of a year-**
238 **end rate base will inflate the Company's return on actual investment?**

239 A. Yes. To illustrate the problem, we can assume steady annual growth in future rate
240 base and the corresponding amount of common equity capital in the utility, at a pace
241 of five percent per year spread evenly throughout each year. The following table

¹⁶ This simplified example ignores changes in other elements of rate base, arising from ongoing capital spending on non-incremental programs, continued growth in Accumulated Depreciation, and changes in Accumulated Deferred Income Taxes and other elements of rate base which are assumed to be largely offsetting in this discussion.

242 shows the impact upon equity returns of targeting an assumed 8 percent ROR on
 243 such a growing rate base, but then calculating revenue requirements on year-end,
 244 rather than average invested capital:

Illustration of Average VS Year-end Rate Base (\$ millions) - post tax return and ROE % difference

Year	Projected Rate Base			Return at 8% on Rate Base		Return ¹⁸ Difference	Average Equity @ 45%	ROE Impact
	Beg. Of Year	End of Year	Average	End of Year	Average			
1	7,000	7,350	7,175	588	574	14	3,229	0.43%
2	7,350	7,718	7,534	617	603	15	3,390	0.43%
3	7,718	8,103	7,910	648	633	15	3,560	0.43%
4	8,103	8,509	8,306	681	664	16	3,738	0.43%
5	8,509	8,934	8,721	715	698	17	3,925	0.43%

245

246 With these assumptions, the post-tax return available for return on equity (“ROE”)
 247 capital exceeds the intended ROE by approximately 43 basis points each year,
 248 adding over \$14 million, plus the related factor-up for income taxes, to the revenue
 249 requirement burden faced by ratepayers. If rate base grows more rapidly than five
 250 percent per year, the ROE variance relative to intended earnings levels would be
 251 even larger, and vice-versa.

252 **Q. Why does the use of a year-end rate base force the achieved ROE to be higher**
 253 **than the intended ROE?**

254 **A.** The utility’s actual investment in new plant and the corresponding growth in newly
 255 invested equity and debt capital tend to grow gradually throughout the year.

256 Therefore, the associated return requirement for such capital also grows gradually

¹⁷ Based upon ComEd’s asserted pretax overall return rate of 12.7%, derived from ComEd Ex. 4.1 as the sum of “Authorized Return” of \$543,733 plus “Incremental Tax Gross-up” of \$298,282 = \$842,015, then divided by “Rate Base” of \$6,647,180 = 12.66%.

¹⁸ These return differences are after income taxes. The equivalent revenue requirement impact of the return differences is approximately 1.66 times the amount shown. See ComEd Ex. 4.3, Sch C-4 at line 13 for documentation of ComEd’s 1.66 Gross Revenue Conversion Factor.

257 throughout the year. If the revenue requirement calculation is improperly based
258 upon the year-end level of such Rate Base investment, as if that investment was
259 fully incurred on January 1 and existed in all months of the test year, the resulting
260 return requirement is systematically overstated. This is the financial result caused
261 by ComEd's proposal to utilize a year-end rate base within the reconciliation
262 process.

263 **Q. If return requirements are overstated relative to the actual amounts of capital**
264 **being invested only gradually throughout a test year, why would regulators**
265 **ever allow utilization of a year-end rate base?**

266 A. The only valid reason for employing a year-end rate base in an otherwise average
267 test year approach is to reduce regulatory lag by approximately six months, which is
268 the difference between the mid-point of an historical test year and year-end. It
269 should be noted that when a year-end or "annualized" rate base is used by
270 regulators, it is common for other elements of the revenue requirement such as
271 wage rates, employee headcounts, customer counts, depreciation expense and other
272 known changes to be similarly annualized at year-end. The combined impact of
273 such broadly applied annualization adjustments is to reduce regulatory lag.

274 **Q. If ComEd's revenue requirements are to now be annually trued-up, so as to**
275 **fully recover jurisdictional actual incurred costs, is there any remaining need**
276 **to address regulatory lag through use of a year-end rate base?**

277 A. No. Traditional test-year regulation involves setting utility rates that remain
278 unchanged until the "next" rate case is filed, causing regulatory lag to exist when
279 cost changes occur between test year rate cases. However, regulatory lag concerns
280 are completely mitigated by the new formula ratemaking regime, where ComEd

281 will be made “whole” with interest for experienced changes in all of its actual
282 jurisdictional costs incurred to provide Delivery Services in Illinois. When the
283 formula-based revenue requirements, which are inclusive of projected net Plant in
284 Service additions, are trued-up through the reconciliation process to actual cost
285 levels, any revenue requirement variances are allowed interest charges to be sure
286 that regulatory lag imposes no financial consequences on ComEd. In this new
287 regulatory environment, there is absolutely no need for the Commission to permit
288 the use of year-end rate base as a remedy for regulatory lag.

289 **Q. With the new annual reconciliation process in place to true-up ComEd’s**
290 **asserted revenue requirement to its actual cost levels, does it matter whether**
291 **the revenue requirement at the inception of formula ratemaking utilizes a**
292 **year-end versus an average rate base?**

293 A. Not particularly. The methodology being used to develop the inception revenue
294 requirement, such as depicted on ComEd Ex. 4.1 at Schedule FR A-1, is of less
295 importance to ComEd’s earnings than the method to be used in the future when
296 calculating the true-up charges or credits to customers in future reconciliation
297 proceedings.¹⁹ The revenue requirement that is ultimately payable by ratepayers is
298 the amount calculated after reconciliation, plus any associated carrying charges on
299 such over or under-recoveries. The Commission’s goal should be to adopt a
300 revenue requirement calculation method that yields a reasonable approximation of
301 the ultimate revenue requirement owed ComEd upon reconciliation so as to
302 minimize the size of future reconciliation revenue adjustments.

¹⁹ This is not to say that inception rates are unimportant to ratepayers or the utility, where actual monthly bills payable by consumers are directly impacted by inception rate levels and the Company’s cash flows are also impacted by the level of inception rates.

303 **Q. In ComEd Ex. 2.1, the Company has proposed a spreadsheet template to**
304 **document the calculation steps to be employed in administering Rate DSPP,**
305 **with the same spreadsheet populated with input values in ComEd Ex. 4.1 TB.**
306 **What changes to this template are needed to ensure that the reconciliation of**
307 **revenue requirements is performed using an average Rate Base approach?**

308 A. The simplest revision would be to insert two additional lines at what is presently
309 identified as Sch. FR A-1-REC in the proposed spreadsheet template. The existing
310 line 12 of this Schedule now references Sch. FR B-1 at line 49 to insert a year-end
311 rate base from the current filing made each year. I would insert one additional line
312 beneath existing line 12 to insert from the prior year's filing the Sch. FR B-1, line
313 49 recorded year-end Rate Base at December 31 of the previous year. Then a
314 second line would be inserted to calculate the mathematical average of the prior
315 year-end and current year-end Rate Base values to quantify an average Rate Base
316 for purposes of calculating the "Net Revenue Requirement – Reconciliation" on
317 Schedule FR A-1-REC each year.²⁰ Conforming changes would be needed within
318 the Rate DSPP to effect reconciliation of the revenue requirement on an average
319 Rate Base approach.

320 A more complex calculation of the actual average Rate Base used in
321 reconciliation could be employed, that would require more elaborate spreadsheet
322 template revisions than are recommended above. For example, certain elements of
323 the Rate Base that are included in the amounts used above are not presently
324 quantified at a single point in time, but are instead based upon 13-month averages

²⁰ It should be noted that ComEd Ex. 2.1 at Sch. FR A-3, at line 1, employs a "DS Rate Base" value from Sch. FR A-1 REC line 12 for determination of the ROE Collar Computation. The changes

325 or specific calculations, such as Customer Deposits, Materials & Supplies and
326 CWC. It may be worthwhile in the interest of accuracy to substitute the most
327 currently available 13 month averages or separately calculated CWC amounts
328 within the average rate base amounts being used in reconciliation. These more
329 complex calculations could be ordered by the Commission to be included in a
330 compliance filing from ComEd once the more substantive issues involving the
331 reconciliation process are resolved.

332 **Q. Are you responsible for development and presentation of the Rate Base to be**
333 **used in calculating the initial formula rate case revenue requirement in this**
334 **Docket?**

335 **A.** No. AG/AARP witness Mr. Effron is addressing the Rate Base issues on behalf of
336 the Attorney General and AARP, except for Cash Working Capital and for the
337 minor rate base impacts of several of my proposed expense adjustments, which are
338 discussed later in this testimony.

339

340 **III. RECONCILIATION INTEREST CHARGES.**

341 **Q. Please describe the Company's proposal with regard to the application of**
342 **interest charges to the revenue requirement reconciliation balance.**

343 **A.** ComEd proposes to apply a "Monthly Interest Rate" of 0.684% to the revenue
344 requirement "Variance – Reconciliation Before Interest" amount calculated on
345 ComEd Ex. 4.1 at Sch. FR A-4. This percentage represents 1/12 of the calculated
346 Weighted Average Cost of Capital that is calculated at Sch. FR D-1 and appears at

proposed herein for derivation of the DS Rate Base on an average basis within Sch. FR A-1-REC
would properly flow through to the ROE Collar computation.

347 line 23. Thus, ComEd is proposing that the revenue requirement difference arising
348 from the reconciliation process, whether positive or negative, be allowed to earn the
349 Company's calculated overall cost of capital, rather than simple interest as provided
350 for in the Act.

351 **Q. Does new Section 16-108.5 of the Act specify the interest rate to be applied to**
352 **the revenue requirement reconciliation balances until such amounts are**
353 **charged or credited to ratepayers?**

354 A. No. Section 108.5(d)(1) of the Act states, "Any over-collection or under-collection
355 indicated by such reconciliation shall be reflected as a credit against, or recovered as
356 an additional charge to, respectively, with interest, the charges for the applicable
357 rate year." However, it does not specify the appropriate interest rate to be used for
358 this purpose.

359 **Q. Should the revenue requirement variances calculated for reconciliation**
360 **purposes be allowed interest at ComEd's overall cost of capital?**

361 A. No. The amounts in question represent short term assets or liabilities that are to be
362 either charged or credited to ratepayers within the annual rate adjustment
363 mechanism. These balances therefore do not require permanent financing by
364 ComEd, and should not be expected to require new Exelon common stock issuances
365 or parent company equity infusions for financing. There is no basis to assume that
366 incremental equity financing will occur in connection with the annual revenue
367 reconciliations. Therefore, ComEd's proposed interest rate that is based upon its
368 overall cost of capital, including a weighted equity return element, should be
369 rejected.

370 **Q. What would be a more appropriate rate of interest for application within**
371 **ComEd's proposed formula rate template spreadsheet, at ComEd Ex. 2.1,**
372 **Schedule FR A-4, line 4, in the Reconciliation Computation?**

373 A. A short term debt interest rate should be used for this purpose, recognizing
374 ComEd's ability to access credit markets at favorable cost rates to finance short
375 term asset investments. For example, the cost of short term debt calculated for 2010
376 at ComEd Ex. 4.1, App 12 is only 1.43%. An alternative cost rate for consideration
377 is the interest rate ComEd currently pays on customer deposit balances, which is
378 presently zero percent.²¹

379 **Q. Would utilization of a short term debt cost rate to calculate interest to be**
380 **applied to revenue requirement reconciliation balances be beneficial to ComEd**
381 **ratepayers?**

382 A. Yes. Short term debt cost rates have recently remained at historically low levels and
383 tend to be generally lower than the costs of more permanent debt capital most of the
384 time. With the large anticipated future infrastructure investments ComEd will make
385 pursuant to new Section 16-108.5 and because inflation impacts upon annual
386 operating expenses are not projected beyond test year end in setting formula rates, it
387 is reasonable to expect future reconciliations to often yield balances chargeable to
388 ratepayers. Under these circumstances, a relatively lower interest rate would be
389 beneficial to ratepayers.

390 **Q. Is there another accounting measure that could appropriately be employed to**
391 **determine the interest cost applicable to revenue requirement reconciliation**
392 **variances?**

²¹ Rate determined by the Commission in Docket No. 11-0793, approved December 21, 2011.

393 A. Yes. The Commission could deem the revenue requirement variances under
394 formula ratemaking to be regulatory assets that represent a deferral of operating
395 expenses to be recoverable (or returnable) in future rate periods. Since operating
396 expenses are income tax deductible when incurred by the taxpayer, the deferred
397 income tax balances associated with such expense deferrals could be used to reduce
398 the balance upon which interest is accrued. Application of interest to only the net of
399 income tax balance associated with such deferrals is consistent with the economic
400 reality that income tax savings would be realized from ComEd's delayed recovery
401 of tax deductible expenses, which should then serve to reduce the overall interest
402 burden upon ratepayers by about 40 percent.

403 **Q. Would it be reasonable to deem the revenue requirement reconciliation**
404 **balances to be deferred operating expenses for this purpose?**

405 A. Yes. The formula-based revenue requirement subject to later reconciliation includes
406 the forecasted amount of all jurisdictional additions to net Plant in Service within
407 Rate Base, but does not provide for projections of inflation in the utility's operating
408 expenses. Aside from differences between actual and forecasted net Plant in
409 Service amounts, the majority of the revenue requirement upon true-up to actual
410 costs is likely to be caused by changes in operating expenses where no cost inflation
411 projections are included.

412 **Q. What changes to ComEd Ex. 2.1, Sch. FR A-4, the formula rate spreadsheet**
413 **template "Reconciliation Computation", are required in order to apply your**
414 **recommendations?**

415 A. First, the "Variance" appearing at line 3 should be reduced by associated
416 incremental deferred income taxes using the Company's composite Effective

417 Income Tax Rate, which is derived on Sch. FR C-4, at line 8. The calculation and
418 subtraction of related Accumulated Deferred Income Taxes could be inserted as new
419 lines 4 and 5 on Sch. FR A-4. Then, the "Monthly Interest Rate" on line 4 (to be
420 renumbered line 6) could be modified to tie to ComEd's calculated current cost of
421 short term debt as determined at App 12 of the template.

422

423 **V. COMED PROPOSED CHANGES TO ICC RATEMAKING POLICIES.**

424

425 **Q. Has the Company proposed any significant revisions to the ratemaking policies**
426 **previously established by the Commission in formulating and populating its**
427 **formula ratemaking calculations at ComEd Ex. 2.1 and ComEd Ex. 4.1?**

428 A. Yes. According to its response to Data Request AG 1.06, the Company has
429 accepted and applied some of the ratemaking decisions from the Commission's
430 Final Order in ICC Docket No. 10-0467, but has not employed established ICC
431 precedent in several other areas in preparing its proposed formula rate filing. The
432 areas where ICC policies are being challenged include changes to jurisdictional
433 allocations for General and Intangible Plant and real estate taxes, inclusion of
434 expenses for restricted stock awards to employees, inclusion of expenses for
435 Perquisites and Awards to employees, and other items as more fully described in
436 this response. I have included as AG/AARP Exhibit 1.5 a copy of the Company's
437 response to Data Request AG 1.06.

438 **Q. Is it reasonable for the Company and for other parties to propose revisions to**
439 **the Commission's established ratemaking policies at this time?**

440 A. Yes. This docket addresses the commencement of an entirely new regulatory
441 framework that provides for annual formula-driven rate changes, along with annual
442 reconciliation calculations to drive revenue requirements toward actual, recorded
443 costs. The previous regulatory framework was based upon traditional, periodic rate
444 case proceedings where there was no systematic, annual updating of rate levels or
445 any reconciliation of revenue requirements to actual recorded costs. It is essential
446 that certain of the Commission's ratemaking policies be evaluated at this time, to
447 ensure compliance with the revisions to the Public Utilities Act and to ensure that
448 just and reasonable rates will result from the new regulatory framework as applied
449 to ComEd Delivery Services.

450 **Q. Are you addressing all of the Company's proposed changes in ratemaking**
451 **policy that are listed in AG/AARP Exhibit 1.5?**

452 A. No. I am not addressing all of the Company-proposed changes. In the testimony
453 that follows, I will address several of ComEd's proposed policy revisions. Other
454 AG/AARP, Staff and Intervenor witnesses may address other changes in their
455 testimony. My responsibilities in this docket were limited due to time and resource
456 constraints, so the absence of testimony on any particular issues should not be
457 construed as acceptance or rejection of ComEd's proposed ratemaking methods in
458 any issue areas not specifically addressed in my testimony.

459
460

461 VI. CASH WORKING CAPITAL.

462 **Q. Has ComEd proposed inclusion of an allowance for Cash Working Capital**
463 **(“CWC”) within the rate base used to establish annual formula rates?**

464 A. Yes. ComEd Ex. 2.1 at App 3 is a blank template the Company proposes be used to
465 calculate in the future an allowance for CWC in setting formula rates. The inputs
466 on App 3 are “Sourced” to ComEd WP 3 which is contained in ComEd Ex. 4.2,
467 where the income statement input values for the CWC computation are presented.
468 ComEd’s actual calculation of CWC under the Trailer Bill is set forth at ComEd Ex.
469 4.3, App 3 TB and in ComEd Ex. 8.1 TB. ComEd’s lead/lag study supports a
470 claimed CWC allowance of \$48,931,000.

471 **Q. Has ComEd applied the ratemaking policies for CWC that were set forth in**
472 **the Commission’s Final Order in Docket No. 10-0467?**

473 A. Not completely. Several changes were made by Mr. Hengtgen relative to the CWC
474 calculation methods that were approved by the Commission in the Company’s prior
475 rate case. These changes include:

- 476 • ComEd has assigned a full revenue lag to the collections of certain pass-
477 through taxes and fees and modified the expense payment leads for certain
478 of these payments.²²
- 479 • ComEd has calculated and added an amount of CWC for non-AFUDC
480 CWIP.²³

²² ComEd Ex. 8.0, p. 21, lines 404-410.

²³ Id. Lines 410-413.

481 • ComEd has not adopted the Commission-ordered 45.35 payment lead day
 482 value for intercompany transactions, to correct for cross subsidization that
 483 is generally prohibited in affiliated interest agreements, instead proposing
 484 a 30.55 lead day result from ComEd's analysis of calendar 2010 affiliate
 485 payment data.²⁴

486 **Q. In your Direct and Rebuttal Testimony in ComEd's last rate case, Docket No.**
 487 **10-0467, you explained a number of problems with the Company's method of**
 488 **calculation to estimate the revenue collection lag. Does the Company's lead lag**
 489 **study in the instant Docket make any correction for these problems?**

490 **A.** No. The revenue collection lag underlying the asserted CWC amounts is still being
 491 estimated by ComEd through application of very crude assumptions to broad
 492 categories of month-end accounts receivable balances. ComEd does not actually
 493 measure how long it takes to collect revenues from its customers. Instead the
 494 Company looks to a breakdown of its month-end Accounts Receivable balances by
 495 customer class and assigns, without any supporting analysis, the following
 496 arbitrarily assumed revenue collection dates to each grouping of aged receivable
 497 balances:

Receivable Age>>	0 - 30	31 - 60	61 - 90	91 - 120	121 - 150	151 - 180	181 - 210	211 - 270	271 - 365
Residential	0	45	75	105	135	165	195	240	317.5
SCI	8	45	75	105	135	165	195	240	317.5
LCI	8	45	75	105	135	165	195	240	317.5
Railroad	0	0	15	45	75	105	135	165	287.5
Street Lighting	0	0	15	45	75	105	135	165	287.5
Public Authority	0	0	15	45	15	45	75	105	287.5
Government	0	8	45	75	105	135	165	195	302.5

²⁴ Id., p. 15, lines 281-285.

498

499 For example, all of the residential customer accounts with balances owed that were
500 31-60 days old were assumed be paid precisely at the mid-point of this period, on
501 day 45, and all Residential customer accounts with balances 61-90 days old are
502 assumed to be fully paid to ComEd precisely on day 75, which is again the
503 mathematical mid-point of the period. Similar “mid-point” assumptions were
504 employed throughout ComEd’s calculations, with no further analysis to determine
505 within these broad aging categories when customers, on average, are actually
506 paying their bills.

507 Equally crude “grace period” assumptions made by ComEd cause certain
508 early aging categories to arbitrarily deviate from consistent use of the Company’s
509 mid-point assumptions that are employed elsewhere. For example, ComEd
510 assigns an assumed zero lag value to all Residential balances 0-30 days old and
511 assigns an 8 day value to small commercial and industrial (“SCI”) and large
512 commercial and industrial (“LCI”) accounts falling within the same aging
513 category. It is highly unlikely that all of the commercial customers in the SCI and
514 LCI classes that pay their bills within 30 days also happen to elect to pay on
515 exactly day number 8 in that aging group, as assumed by ComEd. I submit that it
516 is factually impossible for all the residential customers who pay within the first 30
517 days after their bills are rendered to have actually paid on day number zero, as
518 assumed by ComEd.

519 Problems are also obvious at the other end of the Accounts Receivable
520 aging spectrum where ComEd has applied its mid-point assumptions. Extremely

521 old receivables that have been outstanding more than 90 days are fully considered
522 within the ComEd approach and contribute heavily to the Company's estimated
523 revenue collection lag. ComEd's calculations fail to acknowledge that a large
524 percentage of the oldest Accounts Receivable balances will ultimately become
525 uncollectible and not be collected at all. There is no cash flow associated with a
526 customer bill that is not paid, so the uncollectible portion of ComEd's oldest
527 receivable balances, which are never satisfied by customer remittances, can have
528 absolutely no impact upon the Company cash flows or CWC requirements.

529 I have included within AG/AARP Exhibit 1.1.6 copies of ComEd's
530 responses to Data Request Nos. AG 1.29, AG 1.30, DGK 1.10 and DGK 1.11 to
531 provide additional information regarding the arbitrary assumptions applied within
532 the Company's revenue collection lag day estimation procedures.

533 **Q. You presented extensive testimony in the Company's last rate case objecting to**
534 **the revenue collection lag calculations that are again being used by the**
535 **Company. How did the Commission respond to your prior testimony?**

536 **A.** At page 48 of the Final Order in Docket No. 10-0467, the Commission rejected my
537 criticisms of ComEd's revenue collection lag calculations. Nevertheless,
538 recognizing that ComEd, in this Docket No. 11-0721, has proposed reconsideration
539 of several CWC issues that were previously resolved differently in the
540 Commission's Final Order in the prior rate case, I believe it is reasonable that the
541 revenue collection lag measurement problems also be re-considered.

542 **Q. What is your recommendation regarding the amount of CWC that should be**
543 **included in ComEd's rate base at this time?**

544 A. I recommend at this time, and only for initial determination of the inception rates
545 that will later be subject to reconciliation, that the Company's proposed lead lag
546 study at ComEd Ex. 4.3, App 3 TB and Ex. 8.1 TB be modified to reflect the
547 following changes and then employed to set rates:

548 1. Revision of ComEd's estimated revenue collection lag to account for the
549 uncollectible accounts portion of Accounts Receivables used in ComEd's
550 calculation, which are receivables that will not be collected at all, and
551 therefore cannot impact the timing of ComEd's cash flows,

552 2. Removal of non-cash Pension and OPEB accrued expense amounts from
553 the "Receipts" to which a revenue lag value is applied by ComEd.

554 3. Insertion of the Commission's Docket No. 10-0467 ordered payment lead
555 for intercompany transactions, to avoid potential cross-subsidization of
556 affiliate transactions.

557 4. Reinstatement of the Commission's ordered treatment of pass-through
558 taxes, assigning no revenue lag to these amounts where ComEd serves as
559 the collection agent and no tax is owed until after revenues are collected
560 by ComEd.

561 5. Correction of ComEd's inappropriate application of the calculated "Other
562 O&M" payment lead value to CWIP-related Accounts Payable balances.

563 I further recommend that, before any CWC allowance is permitted in future formula
564 rate changes or as part of the reconciliation of 2011 revenue requirements to actual
565 costs in the Company's May 2012 filing, ComEd be ordered to conduct a more

566 extensive analysis of its actual revenue collection lag days and revise the CWC
567 calculations to reflect the results of such study, as more fully described herein.

568 **Q. Have you prepared an Exhibit to summarize the changes you are**
569 **recommending to ComEd's CWC calculations?**

570 A. Yes. AG/AARP Exhibit 1.3 at page 2 is a spreadsheet calculation that reformats
571 and summarizes ComEd lead/lag study Ex. 8.1 TB, to show the line by line impact
572 of each cost element included in the Company's lead/lag study. Lines 1 through 26
573 and columns (a) through (g) of my Exhibit replicate the Company's results on
574 ComEd Ex. 8.1 TB, but combine the Revenue Lag and Expense Lead for each line
575 items so as to show the overall CWC impact of each element of the analysis. This
576 presentation format is useful in isolating the CWC effects associated with the
577 lead/lag study treatment of each category of transaction.

578 After this restatement of the Company's study, at columns (h) through (l),
579 I present a side-by-side calculation showing each change I am proposing to
580 illustrate the resulting differences in CWC. The cells on page 2 are shaded where
581 an AG/AARP change to study inputs has been made.

582 **Q. Please describe the elements within ComEd's 51.25 Revenue Lag Days**
583 **amounts shown in column (c) of AG/AARP Exhibit 1.3.**

584 A. ComEd's revenue lag is comprised of five segments, including:

- 585 1. A customer usage or service period lag of 15.21 days, plus
- 586 2. An average billing period lag of 2.06 days, plus
- 587 3. A collection lag between the billing date and customer remittances
- 588 estimated at 32.24 days by ComEd, plus

- 589 4. A payment processing lag for processing and depositing of remittances,
590 plus
591 5. A bank float of 0.79 days until deposited funds are available for use by
592 ComEd.²⁵

593 As noted previously in this testimony and in Docket No. 10-0467, there are major
594 problems with the third element of the Company's calculation that must be
595 corrected. ComEd should be required to undertake a systematic study of the timing
596 of customers' actual remittances to more accurately estimate its revenue collection
597 lag; using either of the two generally accepted methods used in other regulatory
598 jurisdictions that employ lead lag studies. Until improvements are made in this
599 area, the Company's lead/lag study is hopelessly inaccurate and should not be relied
600 upon in any annual formula ratemaking process.

601 **Q. Why are the revised Revenue Lag Day values that are shown in column (h) of**
602 **AG/AARP Exhibit 1.3, page 2, so much lower than ComEd's 51.25 day overall**
603 **revenue lag that is set forth in column (c)?**

604 A. I have revised the Company's revenue collection lag calculations to remove the
605 portion of Accounts Receivable that ComEd's own analysis predicts will become
606 uncollectible. One of the many problems with the Company's estimation of the
607 revenue collection lag is ComEd's inclusion of uncollectible accounts within the
608 aged Accounts Receivable data. The Company's oldest tiers of Accounts
609 Receivable contain a higher percentage of individual customer balances that are at
610 high risk of ultimate write-off as uncollectible. However, ComEd's calculation to
611 estimate the revenue collection lag day value gives no consideration to the
612 heightened risk of uncollectibles among the oldest outstanding customer accounts.

²⁵ ComEd Ex. 8.0, p. 7:130 – p. 10:178.

613 I have applied the Company's own uncollectible risk factors, as used on ComEd's
614 books to accrue provisions for uncollectibles expense, to the monthly Accounts
615 Receivables data prior to employing ComEd's aging intervals and mid-point
616 procedures. In all other respects, I have retained the Company's arbitrary
617 assumptions and methods in the revenue collection lag calculations used to
618 determine the revised overall revenue lag in column (h) of 46.08 days.

619 **Q. Why is it necessary to remove the estimated uncollectible accounts from the**
620 **Accounts Receivables aging data when estimating the revenue collection lag?**

621 A. Uncollectible accounts are fully reflected in ComEd's data, but such accounts
622 cannot influence the revenue lag days because, by definition, uncollectible accounts
623 do not yield cash revenues. The Company collects no cash when an individual
624 customer's account balance is written off and removed from the Accounts
625 Receivable balance on the books. In place of these "lost" accounts receivable,
626 ComEd is allowed to include uncollectibles expenses within its overall revenue
627 requirement, so that the general body of ratepayers replace the revenue foregone by
628 ComEd whenever individual customers do not pay for service.

629 **Q. How significant is the uncollectible portion of the overall Accounts Receivables**
630 **balance?**

631 A. The total 13 month average Accounts Receivable balance used by ComEd to
632 estimate the revenue collection lag totals \$464.8 million.²⁶ The Accumulated
633 Provisions for Uncollectible Accounts that represent the Company's expectations of
634 Accounts Receivable that will never be collected range from \$72.5 to \$100.5

²⁶ ComEd response to AG 1.26, Attachment I (lead lag workpapers) CFRC 0000404.

635 million, which represents a substantial portion of the total balance. ComEd's
636 reliance upon an aging analysis of Accounts Receivable balances that have not been
637 reduced for the Company's own estimates of uncollectibles is clearly unreasonable.
638 I have included a copy of ComEd's response to Data Request AG 7.02 within
639 AG/AARP Exhibit 1.7 to further explain this point.

640 **Q. What is the source of the uncollectible risk factors you used to reduce the**
641 **Company's Accounts Receivables balances, prior to re-calculating the revenue**
642 **collection lag day value?**

643 A. I relied upon procedures and studies performed by ComEd to quantify its
644 uncollectible expenses, based upon management's estimate of the collectability of
645 the accounts receivable portfolio. These procedures are explained in the
646 Company's response to Data Request No. AG 4.25, which is also included within
647 AG/AARP Exhibit 1.7 (excluding voluminous attachments).

648 **Q. After your proposed adjustment to remove estimated uncollectible accounts, is**
649 **the Company's revenue collection lag estimate reasonable for future use by the**
650 **Commission?**

651 A. No. The revised revenue lag day value resulting from the adjustment to remove
652 uncollectible accounts will modestly improve the accuracy of the Company's study.
653 However, none of the problems and inherent inaccuracies arising from ComEd's
654 arbitrary mid-point assumptions, the use of only month-end Accounts Receivable
655 balances, and the Company's assumptions made regarding billing grace periods are
656 remedied by the changes I have made to the revenue collection lag estimate.

657 **Q. What should be required of ComEd in the future to correct its estimated**
658 **revenue collection lag day value?**

659 A. The Company should be required to conduct statistical samples of actual customer
660 remittances, to determine the average number of days between collection date and
661 the related prior billing date(s). Alternatively, ComEd should be required to collect
662 and analyze its average daily electric service accounts receivables balance, net of
663 the related uncollectibles reserve, to quantify how many days of its sales are
664 “outstanding” within these balances. This Accounts Receivables “turnover”
665 calculation relies upon dividing the net average daily balance of Accounts
666 Receivables by annual utility sales revenues and is routinely used in other
667 jurisdictions to quantify the revenue collection lag for energy utilities. I
668 recommend that ComEd be required to employ either or both of these methods in
669 future lead lag studies to actually measure customer remittance patterns and more
670 accurately quantify the revenue collection lag, before any future CWC amounts are
671 included in rate base.

672 **Q. Have you examined any residential customer bills to test the reasonableness of**
673 **ComEd’s calculated 32.37 day collection lag estimate for its Residential**
674 **customers using the Accounts Receivable aging data?**

675 A. Yes. ComEd provided copies of randomly selected bills for 50 residential
676 customers in two consecutive months, which bills did not show any significant
677 pattern of past due balances. Some delinquencies would be expected within actual
678 customers’ bills if the overall population of Residential customers takes, on
679 average, more than a month (over 32 days) to pay their bills. I have included

680 ComEd's response to Data Request AG 7.06 as AG/AARP Exhibit 1.8 to provide
681 further information in this area. This limited sample of actual residential customer
682 bills and payment history casts serious doubt upon the credibility of ComEd's
683 asserted residential revenue collection lag.

684 **Q. Turning to lead/lag study issues beyond the revenue lag day value, at line 2 of**
685 **AG/AARP Exhibit 1.3, page 2, you have inserted a zero revenue lag day value**
686 **for Employee Benefits – Pension and OPEB expenses. Why is this**
687 **appropriate?**

688 A. This is appropriate because a zero expense payment lead has been assumed by
689 ComEd for these costs without any study or analysis of the timing of actual cash
690 flows associated with pension or OPEB funding transactions. If the Company does
691 not study and measure the timing of actual cash outflows for pensions and OPEB
692 transactions, instead simply assigning a zero lag day value, it cannot reasonably
693 assign a revenue lag day value for the cash inflows representing recovery of these
694 expenses with the effect of increasing asserted CWC.

695 As shown in column (c) of line 2, ComEd's study applies a 51.25 day
696 revenue lag with an assumed zero expense lead to this element of annual expenses.
697 The effect of the Company's treatment is to increase CWC by \$15.8 million, as
698 shown in column (g). This is inappropriate, because both Pension and OPEB
699 expenses are accrual basis expenses that are derived from actuarial studies, for
700 which there are no recurring periodic cash flows that have been analyzed by ComEd
701 to determine CWC impacts. According to ComEd's response to Data Request AG
702 1.27, "ComEd routinely and periodically makes payments to the trusts associated

703 with these benefits. The revenue requirement schedules in this proceeding
704 separately account for the net pension asset, which is the net amount of the
705 cumulative non-cash pension accruals and the cash contributions, as well as the
706 OPEB liability, which similarly represents the net amount of the non-cash accruals
707 and the cash contributions.” While these statements are true, the more important
708 point admitted by ComEd in this response is, “Since these amounts are already
709 included in rate base or earning a return...zero lag days are used. No separate
710 measurement of the cash flows was done and no other analyses, workpapers,
711 projections or correspondence exist supportive of the zero lead days.” In the
712 absence of any analysis of the timing of Pension and OPEB cash outflows, there is
713 no foundation for blindly applying a 51.25 revenue lag day value for the related
714 cash inflows (revenues) associated with these expenses. I have included a copy of
715 ComEd’s response to Data Request AG 1.27 within AG/AARP Exhibit 1.9.

716 **Q. Mr. Hentgen, at page 14, line 276 of his Direct Testimony, states, “ComEd**
717 **includes its Pension and OPEB amounts in the calculation of rate base**
718 **separately so it is not necessary to include a lead time for these amounts in the**
719 **lead lag study as that would be duplicative.” Do you agree?**

720 **A.** Not completely. If Pension and OPEB transactions are recognized elsewhere in rate
721 base, they should not be included in the lead lag study at all. Mr. Hentgen has
722 included pension and OPEB expense recoveries within the revenue cash inflows to
723 which he assigns a revenue lag, while simultaneously assuming no expense lead
724 applies to the related cash outflows for these expenses. If one concludes that the
725 separate inclusion of Pension asset and OPEB liability balances within rate base

726 makes it unnecessary to include a lead value for these transactions, it is equally
727 inappropriate to apply a revenue lag value to these transactions.

728 **Q. At lines 4 and 5 of AG/AARP Exhibit 1.3, page 2, you have changed the**
729 **Expense Lead Day values assigned to InterCompany Billings from the 30.55**
730 **days used by ComEd (in column d) to 45.35 days (in column j). Why has this**
731 **change been made?**

732 A. In Docket No. 10-0467, the Commission Staff proposed modification of the lead
733 days applied to affiliate transactions out of concern that unreasonably expedited
734 payments to affiliates could create an unreasonable cross-subsidy. In the Final
735 Order in Docket No. 10-0467, the Commission adopted the Staff's proposed
736 expense lead days, stating:

737 Finally, with respect to payments of intercompany obligations,
738 ComEd has not shown the need to reject Staff's adjustments in this
739 area. According to the Company's initial brief, ComEd's affiliate
740 invoices it on a monthly basis, on time, and the invoices require
741 payments on or around the 15th of the month following the
742 provision of service. Staff's adjustment is based on this statement.
743 There was no mention of an affiliate agreement to the contrary.
744 Therefore, the Commission accepts Staff's proposed number of
745 expense lead days of 45.35, based on the fact that such payments
746 are within the Company's discretion. [Final Order p.48]

747

748 As a point of reference, the Company's lead lag study concludes that vendors who
749 are not affiliated with ComEd experience a payment lead of 66.82 days which is
750 applied to "Other O&M Expense" at line 7 of AG/AARP Exhibit 1.3, page 2. It
751 would be unreasonable to increase CWC requirements to accommodate more
752 expedited payments to affiliates of ComEd, compared to the timing of payments to

753 other vendors, without some showing by ComEd that the Company is compensated
754 within affiliate billings for such expedited payments.

755 **Q. Do you have a recommendation regarding the quantification of intercompany**
756 **billings and payments made to ComEd's affiliated companies in future lead/lag**
757 **studies?**

758 A. Yes. Exelon BSC is the principal affiliate providing services to ComEd that are
759 recorded as operating expenses. BSC services are provided by employees and
760 vendors who may be paid through systems and procedures that are shared with
761 ComEd, causing the relevant BSC lead days to largely mirror ComEd lead days for
762 payroll and vendor payments. It may be possible to break down these allocated
763 expenses from BSC into their underlying labor and other O&M components, to
764 which ComEd's calculated lag day values for its corresponding directly incurred
765 expenses may be applicable. This would have the effect of disaggregating the BSC
766 intercompany charges into payroll and non-labor expense elements where common
767 systems and policies may be used to pay ComEd and BSC employees and vendors.
768 Such an approach would avoid the potential for affiliate cross-subsidization by
769 charging ComEd customers for CWC that looks past affiliate contract payment
770 terms to consider the timing of actual cash flows for BSC's own disbursements.

771 **Q. At lines 21 and 22 of AG/AARP Exhibit 1.3, page 2, you have set to zero the**
772 **revenue lag days associated with pass-through charges for Energy Assistance**
773 **and Renewable Energy fees and Gross Receipts/Municipal Utility taxes. Why**
774 **is this necessary?**

775 A. ComEd has proposed revisions to the Commission-ordered treatment of pass-
776 through taxes, with no justification for these changes.²⁷ In Docket No. 10-0467, the
777 Commission found that pass-through taxes should not be assigned a revenue lag
778 because they are payable after revenues are collected from customers, stating in the
779 Final Order:

780 The Commission agrees with Staff's interpretation as to the
781 EAC/REC and GRT/MUT tax issues. For the EAC/REC tax, the
782 utility shall remit all moneys received as payment to the Illinois
783 Department of Revenue by the 20th day of the month *following the*
784 *month of collection*. Under the GRT/MUT tax, this ordinance
785 requires ComEd to file a monthly tax return to accompany the
786 remittance of such taxes, due by the last day of the month
787 following the month during which such tax is *collected*. Both the
788 statute and ordinance requires ComEd to remit these pass-through
789 taxes after they have been collected from customers. ComEd
790 stated in its briefs that the Company correctly pays these taxes in
791 the month following activity that occurs in a prior "tax liability"
792 month. The Commission concludes that the CWC calculation for
793 GRT/MUT pass-through taxes should reflect zero revenue lag days
794 and 44.21 expense lead days and zero revenue lag days and 35.21
795 expense lead days for EAC/REC pass-through taxes as supported
796 by Staff. [Final Order page 48]

797 The adjustments I have proposed at lines 21 and 22 of AG/AARP Exhibit
798 1.3, page 2 have the effect of eliminating the revenue lag day values for
799 these pass-through amounts, as previously ordered by the Commission.

800 Additionally, I have revised the expense lead day value for the
801 Energy Assistance Charge because 305 ILCS 20/13 provides that a public
802 utility engaged in the delivery of electricity shall assess each of its
803 customer accounts a monthly charge and shall remit all moneys received as
804 payment to the Illinois Department of Revenue by the 20th day of the
805 month following the month of collection. These terms yield an expense

²⁷ ComEd Ex. 8.0, p. 21; lines 414-428.
Docket No. 11-0721

806 lead days value of 20 days, plus half of the prior month of 15.2 days, for a
807 total expense lead of 35.2 days.

808 **Q. Have there been any changes in the Company's processes for collecting**
809 **and remitting pass-through taxes that justify revising the Commission's**
810 **treatment of these cash flows in determining CWC?**

811 A. No. There have also been no changes in the ordinances or levies associated
812 with each respective tax that may justify the Company's proposed revisions
813 to the Commission-ordered treatment of these items.²⁸

814 **Q. Why have you revised the CWC calculations associated with the**
815 **"Accounts Payable Related to CWIP" at line 26 of AG/AARP Exhibit**
816 **1.3, page 2?**

817 A. It appears that ComEd has applied its expense lead days applicable to
818 "Other O&M expense" from line 7 of the CWC calculation to an Accounts
819 Payable balance associated with CWIP at line 26. This is a meaningless
820 calculation. For all other elements of the CWC calculation, revenue lag and
821 expense lead day values/factors are applied to annual expenses or to annual
822 pass-through tax amounts. Application of an "Other O&M Expense" lead
823 day value to an Accounts Payable balance tells us nothing about the timing
824 of ComEd payments related to CWIP transactions, because lag days are not
825 applicable to Accounts Payable balances. The only explanation offered by

²⁸ ComEd response to Staff Data Request DGK 1.01. In its response to Staff Data Request DGK 1.03, ComEd provided copies of selected ordinances enacting municipal utility/gross receipts taxes, including City of Chicago documentation stating at Section 3-53-040 that "The return and accompanying remittance shall be due on or before the last day of the month following the month during which the tax is collected or is required to be collected under Section 3-53-030."

826 Mr. Hentgen is his statement, "Third, as required by the Order in Docket
827 No. 10-0467, I have reviewed the cash working capital requirements relating
828 to non-AFUDC CWIP. I have included the impact of non-AFUDC CWIP in
829 the results of my study."²⁹

830 Since the Company has quantified an Accounts Payable balance
831 believed to be associated with CWIP included in rate base, I recommend
832 that this balance be directly included in the CWC calculation. This balance
833 is the best indicator of how much of the Company's CWIP balance has not
834 been funded in cash, but rather is being funded by ComEd vendors. A
835 more detailed analysis of the timing of cash flows associated with
836 construction/CWIP transactions could be undertaken, but in the absence of
837 such analysis, directly offsetting the Accounts Payable balance should
838 accomplish a reasonable quantification of vendor-supplied CWC for CWIP
839 transactions.³⁰

840 **Q. Should the negative Cash Working Capital amount you have**
841 **calculated at line 27 in column (I) of AG/AARP Exhibit 1.3, page 2 be**
842 **included in the Company's rate base for determination of the inception**
843 **rates in this Docket No. 11-0721?**

844 **A.** Not directly. The lead day values and factors from columns (h) through (k)
845 of my Exhibit should be used to determine CWC within the Commission's
846 rate order order, after updating the annual expense and pass-through tax

²⁹ ComEd Ex. 8.0, p. 21:410-413.

³⁰ It should be noted that ComEd directly subtracts Accounts Payable balances that are associated with its Materials & Supplies inventories included in rate base, as noted at ComEd Ex. 4.1, App 1, line 61 and ComEd Ex. 4.2, WP14 at line 8.

847 amounts in column (b) at lines 1 through 24 to match the amounts that are
848 finally approved for ratemaking purposes by the Commission. I expect the
849 result of such updating to be negative CWC. A negative CWC result is
850 indicative of the fact that ComEd's ratepayers, employees, vendors and
851 taxing authorities, rather than Exelon investors, are supplying the net cash
852 working capital that is required to operate the business. This negative
853 amount should be included in rate base to fully and properly quantify
854 investors' overall net investment in rate base.

855 **Q. At page 17 of her Direct Testimony, Ms. Houtsma indicates that a lead lag**
856 **study is "time intensive" and she suggests that under formula regulation of the**
857 **Company, "...an updated study of the lead/lag days [be performed] only every**
858 **three years."**³¹ **Do you agree with this recommendation?**

859 **A.** Only after the problems with ComEd's estimated revenue collection lag and other
860 recurring issues are resolved would it be appropriate to perform detailed lead/lag
861 day studies on a three-year cycle. The more intensive analysis recommended herein
862 with regard to revenue collection lag analysis should be undertaken to improve
863 upon the accuracy of the revenue lag, before such lag day values can reasonably be
864 "frozen" for re-use in multiple annual rate adjustment filings.

865

866 VI. JURISDICTIONAL ALLOCATIONS.

867

868 **Q. Earlier in this testimony, you stated that ComEd has proposed changes to the**
869 **methods used to perform jurisdictional allocations in determining revenue**

870 **requirements. What specific jurisdictional allocation changes have been**
871 **proposed by the Company?**

872 A. At page 29 of her Direct Testimony, Ms. Houtsma³² identifies several differences in
873 the jurisdictional allocation of ComEd's costs between the FERC transmission
874 jurisdiction and the ICC retail delivery service business. These include changes to
875 the allocation of General and Intangible ("G&I) Plant, changes to the allocation of
876 Real Estate Taxes, changes in allocation of Late Payment Charges and more
877 detailed calculations of Depreciation expense on projected Plant additions.

878 **Q. With regard to the revisions to G&I Plant allocations, what rationale is cited**
879 **by Ms. Houtsma in support of the proposed changes?**

880 A. For all G&I Plant investment other than Communications Equipment, ComEd
881 proposes to now use a composite wages and salaries allocation factor to allocate
882 investment between the FERC and ICC jurisdictions. This represents a change in
883 allocation methods that apparently is being made to simplify the G&I allocations,
884 reducing the time and expense incurred by ComEd in conducting special studies
885 that were relied upon in the past, while also conforming allocations to what is being
886 used by ComEd in its formula transmission rate filings at FERC.³³

887 **Q. What do you mean by "conforming allocations" to what is being used by**
888 **ComEd in its formula transmission rate filings at FERC?**

889 A. When allocations are aligned or conformed between the ICC and FERC
890 jurisdictions, ComEd will recover 100% of its costs overall when both jurisdictions
891 are combined and will avoid the creation of jurisdictional differences due to

³¹ ComEd Ex. 2.0, p. 17:338-345.

³² Id., p. 29.

892 allocation methods that would otherwise create over or under-recovery of total
893 costs.

894 **Q. Was anything wrong with the allocation methods that were previously**
895 **employed in ComEd rate cases and that have been approved by the ICC?**

896 A. No. Allocation methods necessarily employ the exercise of judgment and more
897 than one approach can produce reasonable results. Ms. Houtsma notes this fact in
898 her testimony by characterizing the prior allocation method used for Tools, Shop
899 and Garage Equipment (Account 394), stating it is, "...not unreasonable to assume
900 that the usage of this equipment will vary in proportion to the type of plant
901 investment, it is also reasonable to assume that the usage of tools will correlate to a
902 labor-based allocator because the tools and equipment are used by employees.
903 Neither method is perfect, although both can be considered reasonable."³⁴

904 **Q. Has the Commission previously considered proposals by ComEd to revise G&I**
905 **allocation methods?**

906 A. Yes. In Docket No. 10-0467 ComEd proposed revising the allocation of G&I Plant
907 based upon wages and salaries. In its Final Order, the Commission rejected the
908 Company's proposed changes, stating:

909 ComEd contends that use of the new procedure is inconsequential,
910 as if the previous methods for functionalizing General and
911 Intangible plant had been used, it would have only been about
912 1.2% lower than the \$1,280,718,000 gross plant that ComEd seeks
913 here. In fact, however, this 1.2% is still several million dollars. It
914 is \$15,368,616, which is not a trivial amount. This contravenes
915 Ms. Houtsma's testimony that ComEd will not over-recover or
916 under-recover using the new methodology. It also belies ComEd's
917 contention that this methodology does not assign more costs to
918 distribution service. The Commission agrees with Staff that these

³³ ComEd responses to Data Requests AG 6.01. The allocation factors now proposed by ComEd are summarized at ComEd Ex. 4.1, Sch FR A-2.

³⁴ ComEd Ex. 2.0, p. 29:605-611.

919 proposed changes should be rejected. ComEd proffers no reason
920 that justifies imposing this additional cost upon ratepayers. The
921 Commission does not approve ComEd's proposed new accounting
922 procedures. [Order p. 41-42]
923

924 The nature of the underlying Plant assets and how they are used has not changed
925 since Docket No. 10-0467, so it is difficult to rationalize why such changes are
926 warranted at this time.

927 **Q. What is the revenue requirement impact of the Company's proposed revisions**
928 **to G&I net Plant investment allocations in this Docket No. 11-0721?**

929 A. According to ComEd's response to Staff Data Request No. PR 1.02, the ICC
930 Delivery Service revenue requirement is increased by \$2.547 million as a result of
931 the proposed changed allocations for G&I Plant Investment and related depreciation
932 expenses. I have included a copy of this response within AG/AARP Exhibit 1.10.

933 **Q. What is your recommendation regarding the Company's proposed changes to**
934 **jurisdictional allocation methods applied to G&I Plant investment and related**
935 **depreciation expense?**

936 A. I recommend that these ComEd proposed changes in T&I Plant allocation be
937 rejected, as there is no justification for increasing the Delivery Service revenue
938 requirement to effect these changes. AG/AARP Exhibit 1.3, page 1 reflects, in
939 column (d) an adjustment to reduce depreciation expense and rate base for the
940 overall impact of ComEd's proposed changes to jurisdictional allocation of G&I
941 investment, as quantified in AG/AARP Exhibit 1.10.

942 **Q. Beyond the changes to G&I investment allocations that was previously**
943 **considered and rejected by the Commission, has ComEd also proposed**

944 **changes in the way property tax expenses are allocated between the FERC**
945 **transmission and ICC delivery service jurisdictions?**

946 A. Yes. Ms. Houtsma also states that, “In prior rate cases real estate taxes were
947 allocated using a variety of methods; in the formula they are allocated using a net
948 plant allocator. This is consistent with how that allocation is made in determining
949 transmission rates and provides a reasonable allocation to delivery service.”³⁵
950 According to ComEd’s response to Data Request 3.01, this change in allocation
951 method increases the Company’s asserted tax expense by \$3.345 million. In its
952 response to Data Request CUB 3.02, the Company opines, “The real estate tax
953 allocation method applied in Docket 10-0467 did not necessarily produce a more
954 accurate jurisdictional allocation than what ComEd has proposed in this instant
955 proceeding” and they provide more detail regarding the allocation studies done in
956 the past to allocate real estate tax expenses. I have included copies of both of these
957 responses to CUB within AG/AARP Exhibit 1.10.

958 **Q. Does the AG/AARP adjustment appearing in column (d) of your AG/AARP**
959 **Exhibit 1.3 include a reversal of the expense impact arising from this**
960 **additional ComEd-proposed change in jurisdictional allocations?**

961 A. Yes. Aside from noting that the new approach to allocated real estate taxes is
962 consistent with methods being used in ComEd’s FERC transmission rate filings, the
963 Company has not justified making this change and shifting more real estate tax
964 expense into the delivery service jurisdiction. I recommend that this change in
965 jurisdictional allocations not be approved without a showing by ComEd that the

³⁵ ComEd Ex. 2.0, p. 30:615-618.

966 previously submitted and ICC-approved cost allocation procedures for real estate
967 taxes were inaccurate or otherwise inappropriate.

968 **Q. In the event the Commission changes its decision in the prior rate order cited**
969 **above, and now approves ComEd's proposed changes in G&I Plant and/or real**
970 **estate tax allocations, is there a another jurisdictional allocation adjustment**
971 **that could be applied to mitigate some of the increased revenue requirement**
972 **arising from the allocation changes?**

973 A. Yes. The Commission could further revise the jurisdictional allocation of Late
974 Payment Fee revenues to treat these revenues as 100 percent ICC jurisdictional.
975 This further change in revenue allocation procedures would help to mitigate the cost
976 shifting impact of the Company's proposed changes in jurisdictional allocations of
977 G&I Plant and/or real estate taxes.

978 **Q. Was the jurisdictional treatment of Late Payment Fee revenues disputed in**
979 **ComEd's last rate case?**

980 A. Yes. In Docket No. 10-0467, the Commission approved an adjustment that I
981 sponsored to assign much more of the Company's Late Payment Charge revenues
982 to the ICC Delivery Service jurisdiction than had been proposed by ComEd.³⁶ Ms.
983 Houtsma references this prior ICC decision at page 30 of her testimony, "...the
984 formula applies nearly 100% of these revenues to delivery service consistent with
985 the Commission's treatment of late payment charges in docket No. 10-0467."³⁷

986 **Q. Has the Company actually included "nearly 100%" of its test year Late**
987 **Payment Charge revenues in determining the delivery service revenue**
988 **requirement in this Docket No. 11-0721?**

³⁶ Docket No. 10-0467, Final Order pp. 305-306.

989 A. ComEd's WPC-23 at Page 2 of 11 shows Account 450 Late Payment Fees (called
990 "forfeited discounts" in the FERC accounts) that total \$36.1 million in total, with
991 about \$2.6 million of this amount attributed to the Company's Transmission
992 business. Thus, the Company is attributing about 93 percent of these revenues to
993 the ICC Delivery Service jurisdiction, with the other 7 percent treated as non-
994 jurisdictional.

995 **Q. Why has the Company attributed some of its Late Payment Charge revenues**
996 **to reduce the formula transmission rates that are regulated by the FERC?**

997 A. According to the Company's response to Data Request AG 4.05, "A significant
998 portion of ComEd's transmission revenues relate to the bundled service it provides
999 under Rider PE, and ultimately retail customers. Since a proportional amount of the
1000 customers' bills relate to transmission, a proportional amount of the Late Payment
1001 Charges should be allocated to transmission. ComEd has consistently assigned a
1002 portion of its late payment charges to transmission (ICC Docket Nos. 05-0597, 07-
1003 07566 and 10-0467)." When asked to provide copies of (or citation to) each FERC
1004 rule, order and/or other authority relied upon by ComEd to attribute Late Payment
1005 charges to the transmission jurisdiction, the Company stated that it "has not relied
1006 on any specific FERC orders." I have included a copy of this ComEd response as
1007 AG/AARP Ex. 1.10.

1008

1009 **VII. OPERATING EXPENSE ADJUSTMENTS.**

1010 **Q. Has ComEd proposed any changes to the Commission's ratemaking policies**
1011 **regarding rate recovery of management retention bonuses, discretionary**

³⁷ ComEd Ex. 2.0, p. 30:619-625.

1012 **management performance awards, stock-based compensation and executive**
1013 **perquisite expenses?**

1014 A. Yes. In Docket No. 10-0467, adjustments were made to normalize the level of test
1015 year retention bonus awards, to exclude recovery of Other Stock Awards and
1016 Executive Perquisites, and to effect a 50/50 sharing of discretionary management
1017 Performance Awards. In this Docket No. 11-0721, ComEd is proposing full
1018 recovery, without normalization adjustments or ratemaking disallowances, for these
1019 types of expenses.

1020 **Q. What was the stated basis for the Commission's treatment of these types of**
1021 **costs in the previous rate case?**

1022 A. According to the Commission's Final Order in Docket No. 10-0467:

1023 The amount of the perquisites and awards here, during the test
1024 year, is more than the total amount for the previous three years. If
1025 the Commission did not amortize these discretionary costs of the
1026 period of time proffered by the AG/CUB, the Commission creates
1027 the incentive for utilities to "shove" discretionary costs into the test
1028 year, in order to make it appear that the utility has less funds
1029 available than it really has. Also, while some of these awards may
1030 benefit consumers, they also undoubtedly benefit shareholders, as
1031 they reward improvements in job performance. Therefore, the
1032 AG/CUB proposals to amortize these expenses over four years,
1033 and to decrease the amount for perquisites and awards by half, is
1034 adopted. The Commission notes that ComEd has articulated no
1035 facts indicating that shareholders do not benefit from these 'perks.'
1036

1037 **Q. Has ComEd provided any evidence that shareholders do not benefit from these**
1038 **"perks"?**

1039 A. ComEd has provided no evidence that these costs are not beneficial to shareholders
1040 or that they provide any measurable benefit to ratepayers.

1041 **Q. Page 3 of AG/AARP Exhibit 1.3 reflects an “Adjustment to Awards and**
1042 **Perquisites” that includes a normalization of the much higher than average**
1043 **Retention Awards paid to Company employees (at lines 1 through 8), a 50%**
1044 **reduction in discretionary Performance Based Awards, and full removal of**
1045 **Other Stock Awards and Perquisites. Were these adjustments calculated by**
1046 **ComEd?**

1047 **A.** Yes. In response to Data Request AG 4.08, ComEd performed and provided (at
1048 Attachment 1, page 2) these calculations to quantify the effect of applying the
1049 Commission’s adjustment made to ComEd’s perquisite and awards in ICC Docket
1050 No. 10-0467. I have included a copy of this response as AG/AARP Exhibit 1.11.

1051 **Q. Is it appropriate to normalize the retention bonuses of \$4.3 million that were**
1052 **recorded in 2010 even though all of ComEd’s expenses will be subject to**
1053 **reconciliation and true up in future proceedings?**

1054 **A.** Yes. ComEd paid retention bonuses to employees in 2010 that were much larger
1055 than in any recent prior year. If large and unusual amounts of Retention Awards are
1056 not consistently normalized, customers will be burdened with excessive rates until
1057 the future date when reconciliation and true-up calculations are performed and
1058 allowed to impact approved rates.

1059 **Q. Turning next to AG/AARP Exhibit 1.3 at page 4, what are the adjustments you**
1060 **are proposing with regard to ComEd’s asserted Incentive Compensation**
1061 **expenses?**

1062 **A.** I am proposing no adjustments for the recorded expenses for the ComEd Annual
1063 Incentive Program (“AIP”) or for the portion of the ComEd Long-term Incentive
1064 Program (“LTIP”) that has not already been removed from expenses in the

1065 ratemaking adjustment explained by Mr. Fruehe.³⁸ The adjustment set forth at
1066 AG/AARP Exhibit 1.3, page 4 removes the portion of the ComEd share of AIP
1067 plan costs that were originally incurred at Exelon BSC pursuant to formula driven
1068 by Earnings per Share metrics, rather than the permissible criteria specified at
1069 Section 16-108.5(c)(4)(A) of the PUA. At line 4, a similar adjustment is proposed
1070 to eliminate AIP charges to ComEd from another affiliated company, Philadelphia
1071 Electric Company (“PECO”). ComEd has made no showing to support recovery of
1072 these affiliate company charges of incentive compensation, pursuant to the recovery
1073 criteria specified in the PUA.

1074 **Q. What is the additional adjustment appearing at line 5 of AG/AARP Exhibit**
1075 **1.3, page 4?**

1076 A. ComEd makes available to certain “Key Managers” an incentive program that
1077 involves the awarding of Restricted Stock in Exelon. In 2010, the Company
1078 recorded jurisdictional expenses of \$1,921,000 based upon the award of 53,670
1079 shares to Key Managers and Directors.³⁹ In Data Request AG 1.15, the Company
1080 was asked to explain in detail each of the performance criteria that were employed
1081 to determine the stock grant amounts for each individual recipient of stock. In its
1082 response, ComEd stated that it “...objects to providing information as to individuals
1083 on grounds that the requested information is not relevant and not reasonably likely
1084 to lead to the discovery of admissible evidence and further would constitute an
1085 invasion of the privacy of the individuals involved. Subject to and without waiver
1086 of this objection, ComEd notes that while individual performance may apply in the
1087 determination of the amount of specific awards, the primary objective of the

³⁸ ComEd Ex. 4.0, p. 23:475 - p. 25:521.

1088 program is to attract and retain key employees.” I have included a complete copy
1089 of this response as AG/AARP Exhibit 1.11.

1090 **Q. Does the expense for awards of Restricted Stock that ComEd incurred in 2010**
1091 **meet the rate recovery criteria specified in the Act?**

1092 A. This cannot be determined, given ComEd’s objection to providing the information
1093 requested in Data Request AG 1.15. Additionally, incentive compensation that is
1094 paid in shares of stock, rather than cash, should be viewed as fundamentally driven
1095 by financial rather than operational metrics, since the value of such shares is tied
1096 most directly to the financial performance of the business, rather than to
1097 measurement of the quality of service provided to customers. I do not believe that
1098 any stock-based compensation arrangement is compliant with the incentive
1099 compensation cost recovery criteria specified in the Act.

1100 **Q. Please describe the items described as “Adjustments Conceded by ComEd” at**
1101 **page 5 of AG/AARP Exhibit 1.3.**

1102 A. In response to the data requests referenced in the “Source” column of this page,
1103 ComEd indicated an intent to revise its asserted expenses and rate base values to
1104 reflect elimination of certain legal fees and sporting event costs.

1105 **Q. What is the purpose of page 6 in AG/AARP Exhibit 1.3?**

1106 A. Page 6 of AG/AARP Exhibit 1.3 is a placeholder to be used for adjustments to the
1107 level of charitable contributions that ComEd seeks to include in rates. ComEd’s
1108 Schedule C-7 is a listing of individual charitable contributions that exceed \$5,000
1109 (plus \$438,000 representing total contributions of less than \$5,000), for which the
1110 Company has proposed total rate recovery of \$5.995 million. The descriptions of

³⁹ ComEd Ex. 4.9, p. 3 of 22, line 6.

1111 each of the itemized donations consist of the name of the organization and a
1112 program area classification added by ComEd. This listing does not specify the
1113 nature of the organization, how the organization meets any of the Commission's
1114 review criteria or whether the services the organization provides are within the
1115 ComEd service territory. The information in Schedule C-7 is therefore insufficient
1116 to determine whether the listed donations meet the statutory standard, as applied by
1117 the Commission in ComEd's last rate case.⁴⁰ Given the large number of national
1118 organizations included in ComEd Schedule C-7 that operate outside the ComEd
1119 service territory, it is imperative that ComEd affirmatively establish how these
1120 donations benefit ratepayers within its service territory. For the listed transactions
1121 on Schedule C-7, ComEd should be expected to present additional evidence
1122 supporting the reasonableness of ratepayer funding pursuant to 220 ILCS 5/9-227
1123 and the policies established by the Commission.

1124 **Q. Did the Commission exclude some of ComEd's charitable contributions in its**
1125 **Final Order in Docket No. 10-0467?**

1126 **A.** Yes. At page 108 of its Final Order, the Commission concluded, "The Commission
1127 concurs with Staff's proposal to disallow charitable contributions made by ComEd
1128 to organizations outside of the Company's service territory. There is no evidence
1129 that these contributions provide any benefit to ratepayers in ComEd's service
1130 territory. The Commission agrees with Staff that it is not reasonable to require

⁴⁰ 220 ILCS 5/9-227 provides in relevant part: "It shall be proper for the Commission to consider as an operating expense, for the purpose of determining whether a rate or other charge or classification is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious or educational purposes, provided that such donations are reasonable in amount." In the last ComEd Rate Order, the Commission concluded that donations must provide a "benefit to ratepayers in ComEd's service territory." Docket 10-0467, Order at 108 (May 24, 2011).

1131 ComEd ratepayers to bear the cost of such contributions. Accordingly, Staff's
1132 adjustment is adopted."

1133 **Q. Did you make an effort to evaluate the overall reasonableness of ComEd's**
1134 **proposed annual budget for charitable giving at ratepayers' expense?**

1135 A. Yes. ComEd is one of several large business units that are owned and controlled by
1136 Exelon Corporation. To my knowledge, the Illinois retail rate jurisdiction provides
1137 Exelon with its only opportunity to make charitable contributions and to then
1138 receive full reimbursement for such contributions from utility ratepayers. In
1139 contrast, the Exelon-PECO utility business in Pennsylvania and the ComEd and
1140 other Exelon transmission businesses that are regulated by FERC do not allow rate
1141 recovery of charitable contributions.⁴¹ This situation provides an opportunity for
1142 the ICC to evaluate the reasonableness of ComEd's overall charitable contributions
1143 in comparison to the level of charitable contributions by the other Exelon business
1144 units, where regulatory policies are less accomodating than in Illinois.

1145 **Q. Did the AG submit any data requests seeking information about charitable**
1146 **contribution expenditures made by PECO, Exelon Generation, Exelon**
1147 **Transmission Company and other Exelon entities for comparison to the**
1148 **ComEd budget for charitable contributions?**

1149 A. Yes. Data requests AG 4.11 and 7.08 were submitted for this purpose. ComEd
1150 objected to providing any information regarding the amounts of charitable giving
1151 that are funded by any other Exelon business units and that are not a party to this
1152 proceeding. I recommend that the Commission determine information about

⁴¹ ComEd's response to Data Request AG 7.08 confirms that recovery of charitable contributions is not included in PECO's rates and that ComEd does not seek recovery of charitable contributions in its FERC formula rate.

1153 comparable levels of charitable contributions among Exelon affiliates to be relevant
1154 to the issue of overall reasonableness of ComEd's proposed spending. This
1155 information would allow the Commission to determine whether ComEd ratepayers
1156 are being asked to pay a disproportionate share of the corporate-wide contributions
1157 of Exelon and other ComEd affiliates. ComEd should supply this information as
1158 soon as possible to give the parties sufficient opportunity to analyze it in
1159 anticipation of an appropriate response.

1160 **Q. Why have you included, at page 7 of AG/AARP Exhibit 1.3, a calculation**
1161 **applying a zero interest rate to the Customer Deposits balance included in**
1162 **ComEd's asserted Rate Base?**

1163 A. The Company apparently neglected to account for interest expense on Customer
1164 Deposits. It is unusual for the interest rate to be zero on such balances, so I have
1165 included page 7 as a place holder to indicate the recognized need to account for
1166 interest on such deposits in future formula rate calculations. In future formula rate
1167 proceedings, interest expense should be added into total expenses at a level
1168 corresponding to the balance of Customer Deposits that is included in rate base.

1169

1170 **VIII. CONCLUSION AND RECOMMENDATION.**

1171

1172 **Q. What is your recommendation regarding the initial revenue requirement to be**
1173 **determined for ComEd in this Docket?**

1174 A. I recommend that ComEd's Delivery Service revenue requirement be found to be
1175 no larger than the amount shown in AG/AARP Exhibit 1.3, at page 1, line 25 in
1176 column (k). This amount should be further modified for any Commission-approved

1177 ratemaking adjustments proposed by the Staff and other parties, that is not
1178 addressed in my or Mr. Effron's Direct Testimony.

1179 **Q. What do you recommend regarding the Company's proposed formula rate**
1180 **template set forth at ComEd Exhibit 2.1?**

1181 A. ComEd formula rate template should be modified as necessary to comport with the
1182 ratemaking decisions reflected in the Commission's Order in this Docket.
1183 Corresponding changes to proposed Rate DSPP should also be submitted in a
1184 ComEd compliance filing, subject to review by Staff and other parties, prior to the
1185 new formula rate tariff being made effective.

1186 **Q. Does this conclude your testimony at this time?**

1187 A. Yes.