

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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

**REPLY BRIEF OF THE CITIZENS UTILITY BOARD  
AND THE CITY OF CHICAGO**

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## I. INTRODUCTION/STATEMENT OF THE CASE

Now come the Citizens Utility Board (“CUB”) and the City of Chicago (“City”), pursuant to Rules of Practice of the Illinois Commerce Commission (“ICC” or “the Commission”), 83 Ill. Admin. Code Part 200, and pursuant to the briefing schedule established by the Administrative Law Judges (“ALJs”) on November 30, 2011, to hereby file this Reply Brief in the above captioned proceeding. This proceeding is the initial rate-setting docket for the Commonwealth Edison Company (“ComEd” or the “Company”) under new Section 16-108.5 of the Public Utilities Act (“PUA” or the “Act”). CUB-City respond to the arguments presented by ComEd in its Initial Brief, and explains that the Energy Infrastructure Modernization Act (“EIMA”), Public Act 97-0616, as modified by Public Act 97-0646, does not diminish the Commission’s authority—and duty—to set rates that are just and reasonable and are based on prudently-incurred costs. ComEd agrees with CUB/City that this new option for setting delivery service rates in the EIMA is designed so that ComEd can make investments that “provide new and innovative customer rates,” including customer benefits beyond those specifically names in the EIMA. Tr. At 158, 162. CUB/City recommend that the Commission adopt the regulatory practices and accounting adjustments recommend here and in CUB/City’s Initial Brief in order to ensure that the EIMA results in real and material benefits to ComEd customers.

Although EIMA represents a significant change in the way electric utility rates are set, the ICC is still required to ensure that delivery service rates for electricity are just and reasonable, and that utility investments are prudently made. 220 ILCS 5/16-108.5(c)(6); *see also* Illinois Industrial Energy Consumers (“IIEC”) Init. Br. at 2, 5. This Commission authority includes the authority to do what is reasonably necessary to accomplish the legislature’s objective. *Abbott Lab., Inc. v. Ill. Commerce Comm’n*, 682 N.E.2d 340, 347 (5th Dist. 1997).

The EIMA does not change the ICC's role in "effectively and comprehensively" requiring ComEd to provide "adequate, efficient, reliable, environmentally safe and least-cost public utility services." 220 ILCS 5/102. The new parts of the Act reinforce the existing evaluation lodestars of "prudence" and "reasonableness" – as ComEd admits. Tr. at 141.

Inherent in any utility's expenditures are the risks that (1) the expenditure will become more costly than expected; (2) benefits from the expenditure will be delayed; (3) benefits produced will be fewer than expected; (4) neither the utility nor the customer needs the benefits from the expenditure; and (5) expenditures unknown at approval turn out to be more cost-effective.

The new formula rate option under the EIMA increases these risks because ComEd seeks prudence decisions prior to expenditures – denying the ICC the perspective it would have if it were permitted to review a decision after it were made. Small expenditures, which risk upward adjustments due to unexpected costs, could pass the point of no return where the incremental cost of completing the initial expenditure is less than total costs of a new alternative. *See* IIEC Init. Br. at 4. Thus, consumers bear not only the risk of ComEd's unlucky business decisions; they also bear the risk of decisions induced as a result of the shifted risk of unlucky decisions. In other words, successful expenditures can enter rate base and earn a profit for ComEd while benefitting customers, while unsuccessful expenditures enter rate base and earn a profit for ComEd but provide no benefit to customers. To minimize the risks shifted to consumers as a result of the EIMA, the Commission should examine each ComEd expenditure using six regulatory principles:

**A. Applying Prudency and Reasonableness**

The Act allows ComEd to recover its actual costs of delivery services that are “prudently incurred and reasonable in amount consistent with Commission practice and law.” 220 ILCS 5/16-108.5(c)(1). The ICC can disallow otherwise prudent expenditures when the risk of prudent but uneconomic actions should fall on ComEd, as ComEd admits the Commission can through reconciliations of expenditures and projections of capital to-be-spent. Tr. at 180; ComEd Corr. Init. Br. at 1. An expenditure must be the lowest-feasible-cost means, at the time of decision, of achieving ComEd’s prudent objectives. The prudence of a specific expenditure depends on the prudence of larger, related expenditures. Therefore, ComEd must prove that both expenditures and projects are prudent in light of feasible alternatives.

**B. The ICC Should Require ComEd to Commit to and State All Costs and Expected Benefits of All Expenditures**

No expenditure is “prudent” or “reasonable” simply because it relates to a project named in the EIMA. The Commission should require ComEd to accurately and timely state all costs and expected benefits for all proposed projects under its “unambiguously preserved ... duty ... to review the prudence and reasonableness of costs and ensure the accuracy of cost and revenue data.” ComEd Corr. Init. Br. at 2. Cost-effectiveness should be judged in the context of all relevant alternatives, motivating ComEd to excel and penalizing it for poor performance. ComEd should also describe efforts to cap vendors’ costs, to avoid any alleged speculation required of outsider Commission Staff or intervenors when attempting to determine possible negative outcomes from proposed expenditures.

**C. Prudency Determinations Require Detailed Information on Costs and Benefits**

ComEd acknowledges that the planned \$2.6 billion of investments under EIMA include risks of changing project size and costs. Tr. at 135; 156-58. Prudence and reasonableness determinations should not confuse incurred costs with prudent or reasonable ones. When negative outcomes from expenditures are only speculative possibilities at the time of the ICC's decision, the Commission risks granting piecemeal approval without a clear picture of an entire investment project. The resource differential between ComEd and the Commission worsens this clarity problem. Therefore, the Commission should require ComEd to document expenditures with comparative analyses of all relevant alternatives to determine whether the end result is one a reasonable person would be expected to exercise under the same circumstances encountered by utility management. The combination of the Act's directed expenditure amount and the provision which terminates the formula rate upon failure to spend the amount creates the risk of unnecessary expenditures. *See* 220 ILCS 5/16-108.5(b). What infrastructure is necessary depends on customers' consumption patterns, therefore, dynamic rates are key to ensuring customer benefits from ComEd's expenditures.

**D. ComEd's Costs Should be Connected to Projects That Promise Long-Term Customer Benefits**

In addition to the required prudence and reasonableness of any particular expenditure, long-term investment projects must be based on committed benefit/loss sharing with customers. The ICC can begin by evaluating expenditures against goals from EIMA, but must also ensure that approved expenditures reflect best practices at lowest feasible cost. A credible long-term plan evaluates a full range of alternatives to measurably determine lowest cost and best

performance – taking into account reasons to change the long-term plan suggested by the measured success or failure of specific expenditures.

**E. Evaluation Under the Formula Rate**

The Commission must be ready to recognize expenditures that are based on facts that may change, requiring a shift to better alternatives in order to provide the lowest feasible cost electric delivery service. Without proper timing, the Commission risks making capital expenditures before consumers have made behavior changes that would obviate the need for the expenditures. If customers must pay for sunk costs, they have less incentive to align their behavior with customer benefit-maximizing practices. Thus, any proposed projects must be periodically re-evaluated to offer opportunities for competitive alternatives. Every project must be undertaken by the best performer, whether the utility or a vendor – subject to prudence and reasonableness standards proven by ComEd. FERC Form 1 data are only a fraction of the information necessary to determine the best alternative under this standard. Information regarding the best performing utilities must be provided by ComEd to meet their statutory burden, especially in light of any resource differential between the utility and intervenors.

**F. The ICC Should Focus on Utility Performance**

ComEd’s private behavior must be aligned with the public interest of its customers – including the best possibilities for new products, services, providers, and technologies in the world of EIMA-induced investment. Particularly, the Commission should evaluate whether:

- a. ComEd has achieved new levels of performance in customer service at higher levels of cost-effectiveness;
- b. New opportunities have arisen for customer investment in energy efficiency and demand response technologies;
- c. Customers have received timely and useful information on how to manage their energy costs and consumption;

- d. Customer have enrolled in new rate programs that offer customer savings; and
- e. ComEd's investment are cost-effective over the ten years of investment, in general plant and smart grid technologies.

**III. RATE BASE**

**C. POTENTIALLY CONTESTED ISSUES**

**1. Average Year or End of year Rate Base (see also VIII.C.1)**

Section VIII.C.1 below explains that the correct calculation of rate base in ComEd's reconciliation filing should use average year, rather than end of year rate base.

**2. Plant-in-Service**

**b) 2010 General and Intangible Plant Functionalization**

**(1) Methodologies**

ComEd (1) functionalized General Plant Account 397 based on a direct assignment study, and (2) functionalized the remaining G&I Plant Accounts based on the general labor allocator, also known as the wages & salaries ("W&S") allocator. ComEd Corr. Init. Br. at 27-28. In ComEd's opinion, this method is a superior approach above what was used in ComEd's prior delivery services rate case, and simplifies and streamlines the splitting of these costs without sacrificing accuracy. *Id.* at 28. Staff, AG/AARP, and CUB all recommend that the Commission, reject ComEd's proposal because it is proposing a change inconsistent with the methodology the Commission approved in *ComEd 2007* and *ComEd 2010*. Using the approach previously approved by the Commission results in a total reduction in plant of \$18,197,000 and depreciation expense of \$492,000. *See e.g.*, Rukosuev Dir., Staff Ex. 10.0, 10:216-11:228; Bridal Dir., Staff 29 Ex. 5.0, Sched. 5.03; Brosch Dir., AG/AARP Ex. 1.0, 39:868-42:941; Smith Dir., CUB Ex. 1.0 Rev., 22:493 – 25:552.

The functionalization approach by the Commission in Docket Nos. 10-0467, 08-0532, 07-0566 and 05-0597 continues to be the most appropriate method. Staff Init. Br. at 9. General

and intangible plant falls into the category of common costs, which are costs used to serve multiple utility functions. *Id.* The Company offers no reason why, under the formula rate proposal, a change in jurisdictional plant is appropriate. There have been no changes in the underlying assets or in how they are used to justify a departure from past practice. AG Init. Br. at 12 (*citing* tr. at 1007-08).

The best defense ComEd can muster to defend its proposed deviation from the Commission's repeated decisions on this point is to say that it has met a prima facie case showing its approach is superior and, since no party refuted ComEd's assertions that these expenses were reasonable and that ComEd's approach was simple. ComEd Corr. Init. Br. at 30-31. ComEd's strongest claim appears to be that ComEd's proposal is "at least as reasonable as the old methodology." *Id.* at 31. None of these arguments merit the ICC's departure from past practice. In *Central Illinois Public Service Company v. Illinois Commerce Comm'n*, 5 Ill. 2d 195 (1955) ("*CIPS*"), the Court rejected CIPS' argument that the Commission must accept a proposed rate except where there was evidence that "the proposed rate was unreasonable and that some other rate was reasonable." *Id.* at 211. The Court noted that if the utility's position were correct, a utility "would be encouraged to adduce as little evidence as possible before the Commission. We do not think the act contemplates such an anomaly." *Id.* Requiring intervenors to establish unreasonableness is no substitute for requiring proof of reasonableness. *People ex rel. Hartigan v. Ill. Commerce Comm'n*, 117 Ill. 2d 120, 135-136 (1987).

The fact is ComEd's proposal is inappropriate and inconsistent with the Commission's Order in 10-0467. CUB Ex. 1.0 at 22-25; CUB Ex. 3.0 at 35-39. Doing so significantly and improperly increases the Company's rate base by \$18.197 million. Staff, the AG and CUB all

agree: there is no reason for the Commission to depart from its past practice, and ComEd's proposal to do so should be rejected.

**d) Derivative: Restricted Stock**

ComEd's rate base should be adjusted to remove the capitalized restricted stock from Construction Work in Progress/Accumulation, reducing ComEd's rate base by \$787,000. As discussed below in Section V.C.1.b and consistent with the Commission's Order in Docket 10-0467, costs of restricted stock are related to the performance of ComEd's parent company and should be borne by shareholders. This adjustment is also related to the adjustment in Section V.C.1.b.

**e) Derivative: Incentive Compensation**

ComEd's rate base should be adjusted to remove the capitalized portion of 2010 Annual Incentive Plan cost in excess of 100 percent of the target level. This is related to the adjustment in Section V.C.1.c below.

**f) Derivative: Perquisites and Awards**

ComEd's rate base should be adjusted to remove capitalized Other Stock Awards and Perquisites of \$40,000, Retention Awards cost of \$427,000, and 50% of Performance Awards, amounting to \$25,000, totaling capitalized miscellaneous disallowances of \$492,000. This adjustment is related to the adjustment in Section V.C.1.d below.

**4. Cash Working Capital Issues**

Several parties criticized numerous aspects of ComEd's calculation of its cash working capital ("CWC") during the evidentiary portion of this case. CUB-City Init. Br. at 20;.. Those criticisms continued in the initial briefs. *Id.* at 20-25; AG-AARP Init. Br. at 13-40; IIEC Init Br. at 27-31; Staff Init. Br. at 26-33. For its part, in its brief, ComEd repeated the arguments that it

made in testimony. ComEd Corr. Init. Br. at 37-43. These arguments that are not persuasive and should be rejected by the Commission. Responses to ComEd's positions on the various aspects of its CWC calculation are below.

**a) Revenue Collections Lag**

ComEd's Initial Brief ignores CUB witness Ralph C. Smith's proposed adjustment to its revenue collection lag for the Company's failure to remove uncollectible amounts from its Accounts Receivable. As Mr. Smith explained, it is improper for ComEd to include uncollectible amounts in its Accounts Receivable because "ComEd collects cash only from customers who pay their bills. No cash is collected from customers who do not pay their bills. Thus, the revenue collection lag should be computed only on the collectible portion of Accounts Receivable that becomes actual cash payments." CUB Ex. 3.0 at 10. ComEd did not respond to Mr. Smith on this point; thus the Commission should adopt Mr. Smith's recommendation in his Direct Testimony that ComEd's revenue collections lag be reduced by 4.5 days. CUB Ex. 1.0 at 32. Alternatively, as Mr. Smith explained in his Rebuttal Testimony, the Commission could adjust ComEd's revenue collection lag by 5.17 days based on the Company's response to AG data request 10.13 (attached to Mr. Smith's Rebuttal Testimony as CUB Ex. 3.1).<sup>1</sup>

**b) Pass-Through Taxes**

Despite Commission decisions in its last rate case that the lag time for the Energy Assistance Charges/Renewable Energy Charges ("EAC/REC") and Gross Receipts/Municipal Utility ("GRT/MUT") pass-through taxes should be zero, ComEd continues to argue that its proposed revenue lag of 51.25 days be adopted. ComEd Corr. Init. Br. at 39-41. ComEd makes no mention of the findings on these issues in the Commission's Order in Docket 10-0467.

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<sup>1</sup> AG-AARP also criticized ComEd's practice of including uncollectible accounts from its Accounts Receivable. AG-AARP Brief at 30.

Instead, ComEd claims that arguments made by CUB-City, AG-AARP, IIEC, and Staff fail to acknowledge that ComEd is legally obligated to collect these taxes and that Staff and intervenor arguments about when ComEd can remit these taxes ignore when ComEd does remit these taxes. *Id.* at 40. ComEd’s arguments fail to account for the facts that the utility is not obligated to remit the EAC/REC charges until 20 days after the month the utility collects the charges. CUB Ex. 3.0 at 3-4. The GRT/MUT taxes are not required to be remitted until the last day of the month after the taxes were collected or are required to be collected. *Id.* ComEd’s point that these facts are not relevant because they ignore when ComEd actually remits these payments was nicely addressed by IIEC when it argued that “prepayment of taxes and charges could be considered imprudent....” IIEC Init. Br. at 30. As IIEC added, it is unfair for the utility to ask ratepayers “to pay more for electric service because ComEd has volunteered to remit these taxes and charges before it is ... required to do so.” *Id.*

As Staff notes, ComEd admitted that its collection and remittance practices for EAC/REC and GRT/MUT have not changed. Staff Init. Br. at 28. Therefore, there is no factual basis for the Commission to change its findings in Docket 10-0467 that zero lag days should be used for those charges and taxes.

**c) Intercompany Billing Lead**

As with the EAC/REC and GRT/MUT charges and taxes, ComEd chose to ignore the Commission’s Order in Docket 10-0467 which rejected ComEd’s proposed payment lead for inter-company of 15 days. Instead, the Commission adopted Staff’s proposal to increase the payment lead for such payments to 30 days. ICC Docket 10-0467, Final Order at 48.

ComEd fails to mention the Commission’s decision on this issue in its brief. Rather, ComEd takes issue with arguments that the fact that payment times for affiliates is far shorter

than the payment times for non-affiliates is not relevant because, according to the utility, “the circumstances are not parallel.” ComEd Init. Corr. Br. at 41-42. It is not clear what ComEd means by this and the Company provides no citation as to where this statement might be explained. Whatever the point of ComEd’s claim, the record evidence shows that ComEd has an average payment lead of 55.04 days for its operations and maintenance vendors. Staff Ex. 3.0 at 13. Yet, for cash working capital purposes for inter-company transactions, ComEd uses a payment lead time of 15 days for affiliates. *Id.* at 12-13. Staff witness Daniel G. Kahle testified that ComEd failed to produce any sort of inter-affiliate agreement requiring ComEd to pay affiliates by the 15<sup>th</sup> of the month. *Id.* at 14. In short, ComEd submitted no evidence as to why the Commission should change its conclusion regarding the payment lead for inter-company transactions it made in Docket 10-0467.

**d) Employee Benefits – Pension and OPEB Lead**

ComEd makes a cursory effort to respond to Mr. Smith’s argument that zero lead days should be assigned for pension and other post-employment benefits (“OPEB”). ComEd Corr. Init. Br. at 42. Mr. Smith testified that in response to a discovery request from the AG, ComEd stated that a zero lag day amount is used for pension and OPEB amounts. In that same response, ComEd admitted that there was no measurement done to support the calculation. CUB Ex. 1.0 at 30. However, with respect to lag days, ComEd impliedly applied its proposed revenue lag of 51.25 days, creating a CWC requirement of approximately \$15.8 million. *Id.* AG-AARP witness Michael L. Brosch explained that both Pension and OPEB expenses are accrual basis expenses that are derived from actuarial studies, for which there are no recurring periodic cash flows that have been analyzed by ComEd to determine CWC impacts. It is completely unreasonable for ComEd to attribute a revenue lag

for the delay in cash recovery of these expenses, but then simply pretend that cash has been disbursed immediately when recording accrued pension and OPEB expenses on its books, as if cash has been disbursed immediately with no delay beyond the date of the accrual entry. AG-AARP Ex. 1.0 at 32.

In short, Mr. Smith's and Mr. Brosch's respective adjustment to CWC regarding pension and OPEB expenses should be adopted.

**e) Accounts Payable Related to CWIP**

ComEd asserts that there are no issues with respect to accounts payable related to non-allowance for funds used during construction ("AFUDC") construction work in progress ("CWIP") because it agreed to Staff's two-part proposal to exclude non-AFUDC-CWIP from rate base. However, as Staff points out, CUB witness Smith, AG-AARP witness Brosch, and ComEd's witness John Hengtgen differ on the amount of Accounts Payable Related to CWIP that should be included in CWC. For the reasons stated in Mr. Smith's direct and rebuttal testimonies and CUB-City's Initial Brief, the Commission should adopt Mr. Smith's recommendation.

**5. Accumulated Deferred Income Taxes**

ComEd's arguments concerning the calculation of Accumulated Deferred Income Taxes ("ADIT") on its 2011 Plant Additions, Bad Debt Reserve, Vacation Pay, Incentive Pay and FIN 47 are not persuasive. The Commission should reject ComEd's significant omissions and underestimations which, if left uncorrected, will force ratepayers to pay unnecessarily high rates from the time these rates are set until the first reconciliation.

**a) 2011 Plant Additions**

ComEd presents three arguments<sup>2</sup> with respect to the calculation of ADIT on 2011 plant additions. First, ComEd invokes Section 16-108.5(c)(6) of the Act, which requires updating two items (depreciation reserve and expense) but does not specifically list ADIT as an item which must be updated, to support its omission of the substantial ADIT resulting from the 2011 bonus federal income tax depreciation. ComEd Corr. Init. Br. at 44. The Act lists just two general items, and does not bar the Commission from incorporating any other appropriate adjustments. In fact, it is the Commission's duty to provide only for "the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." 220 ILCS 5/16-108.5(c). The Company argues that statutory construction requires that since certain items are listed and others are omitted, the correct construction is that the omissions are intended as exclusions. ComEd Corr. Init. Br. at 45. However, Section 16-108.5 is expressly subject to the Commission's Article IX duty to ensure only prudently incurred, reasonable costs are included in rates. 220 ILCS 5/16-108.5(c). That requires considering contemporaneous offsets to projected costs. The Commission must consider the ADIT on 2011 plant additions, which is a significant offset in 2011 that if not adjusted will greatly overstate rate base in this, the first case setting ComEd's formula rates.

ComEd's second argument is that "while it is correct that adding ADIT for the 2011 plant addition would make the rate base closer" as to this item, there are other changes to ADIT and other rate base and operating expenses that are not being made. ComEd Corr. Init. Br. at 44. Its third argument, related to that idea, is that it is unnecessary to include this adjustment at this time because the reconciliation will account for it. As IIEC pointed out, that argument is meaningless since all deviations from ComEd's actual costs, no matter how unreasonable, should be captured

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<sup>2</sup> ComEd presents its arguments as being four separate theories; however, its first and fourth arguments both argue statutory construction and will be discussed as one argument here.

in later reconciliations. IIEC Init. Br. at 34. However, even if they will be captured and reflected in rates going forward after the first reconciliation, ratepayers will be harmed if forced to over-pay from now until that time. Even ComEd's own witness agreed that the statutory promise of a later reconciliation does not allow the Commission to approve a rate base that is not prudent, just and reasonable. Tr. at 141. The Commission should not allow over-collection in the time between this case and the time when rates from the first reconciliation will go into effect, and should ensure ratepayers pay only for actual costs.

Including the effect of the 2011 bonus tax depreciation keeps this item as close in rates as it is to its actual calculation—an appropriate outcome consistent with the Act. CUB Cross Ex. 1 includes ComEd's most recent estimation of this adjustment, and should be used by the Commission.

**b) Bad Debt Reserve**

ComEd argues against allocating this item consistently with the allocation of bad debt expense, claiming it is inconsistent with the decision in the last ComEd rate case to credit distribution rates with all late payment charge revenues. ComEd Corr. Init. Br. at 46. CUB-City's argument, along with that of AG-AARP and Staff, is straightforward and consistent – the ADIT associated with bad debt reserve should be allocated using the same method that was applied to the uncollectible expense that gave rise to that ADIT. The Company's arguments as to inconsistency with the last rate case order are astonishing given the numerous areas where ComEd itself proposes to deviate from that Order. This argument, as Staff notes, is a diversion to distract the Commission from its purpose in this proceeding. Staff Init. Br. at 35-36. The ADIT associated with bad debt reserve should be allocated using the same methodology as used by the Company to allocate the bad debt expense which gave rise to the ADIT amount.

**c) Vacation Pay**

This item is related to an adjustment discussed in Section III.C.6.a below. That adjustment addresses how the reserve for accrued vacation pay, which ComEd did not reflect in its determination of cash working capital, should be reflected as offsets to rate base for non-investor provided capital. In conjunction with that adjustment, Mr. Smith recommended restoring the related ADIT in account 190 for this item. CUB-City's and Staff's adjustments with respect to this item remains at issue.

**d) Incentive Pay**

This item is related to an adjustment in Section III.C.6.b below (discussed in depth in III.C.6.a). That adjustment addresses how the reserve for incentive pay, which ComEd did not reflect in its determination of cash working capital, should be reflected as offsets to rate base for non-investor provided capital. In conjunction with that adjustment, Mr. Smith also recommended restoring the related ADIT in account 190 for this item.

**e) FIN 47**

ComEd calls CUB-City's position "one-sided" because ComEd included the ADIT associated with holiday pay, thereby reducing rate base, even though that was inconsistent with the ratemaking treatment in 10-0467. ComEd Corr. Init. Br. at 48. ComEd itself has cherry-picked which adjustments it claims should be approved because they are consistent with the last rate case (*e.g.*, CWC lead/lag study methodology using mid-points in collections lag, *see* ComEd Pre-Trial Memorandum at 21-22) and which adjustments it proposes to treat differently here (*e.g.*, calculation of pass-through taxes in CWC, *see* ComEd Pre-Trial Memorandum at 22). Mr. Smith proposes treating adjustments the same as they were treated in 10-0467. The Commission

should be wary of ComEd's attempt to shift the burden of proof to intervenors rather than making a credible case of its own.

**6. Operative Reserves**  
**a) Accrued Vacation Pay**

ComEd did not recognize the lag in payment for accrued vacation and incentive pay in calculating CWC, thus the accrued liability for these items should be included in operating reserves. CUB Ex. 1.0 at 34-35; CUB Ex. 3.0 at 13-14. Because the payment of vacation and incentive compensation lags considerably more than the payroll reflected in the lead-lag study, deducting related accrued liability balances these items from rate base to appropriately reflect sources of non-investor supplied capital. In surrebuttal, ComEd removed from rate base the ADIT debit balance associated with the operating reserve for vacation pay. ComEd claims that this, in turn, eliminates the rationale for reducing rate base offered by AG/AARP and CUB. ComEd Corr. Init. Br. at 48. This is incorrect because, as noted in CUB's initial brief, removing the debit balance was the least preferable option to adjust the problem identified by AG/AARP and CUB. *See* CUB-City Init. Br. at 29. Instead, the preferable approach is to reflect the reserves as a reduction to rate base since they represent a source of non-investor supplied capital, leaving related ADIT-debit balances in rate base for consistency.

In any event, ComEd argues that current liability associated with vacation pay is short term and thus not a source of funds to finance rate base. ComEd ComEd Corr. Init. Br.at 49. ComEd claims that the impact of the 2010 vacation pay accrual on ComEd's proposed revenue requirement is limited. *Id.* at 49. However limited the impact, the operating reserves related to ADIT-debit balances should be removed from rate base since they represent a source of non-investor supplied capital.

**b) Accrued Incentive Pay**

ComEd claims that, like vacation pay, the short term nature of the accrued liability cannot finance rate base. ComEd Corr. Init. Br. at 49. This item was addressed in Section III.C.6.a immediately above, as the same arguments apply to both adjustments.

**V. OPERATING EXPENSES**

**C. Potentially Contested Issues**

**1. Administrative and General Expenses**

**b) Restricted Stock**

Restricted stock is a form of incentive compensation, for which the Company can recover only reasonable costs that tangibly benefit or save a specific dollar amount for ratepayers or utility service. ICC Docket 07-0566, Final Order at 61; ICC Docket 04-0779, Final Order at 44. ComEd has not identified any tangible ratepayer benefits for its Key Manager Restricted Stock program costing \$1.921 million.

Rather, ComEd claims that this program is not a form of incentive compensation. Even if the program is “deferred” compensation, its purpose is the same as that of any other incentive compensation program and, as Staff witness Ebrey and AG/AARP witness Brosch explained, the program must meet the same legal standard. ComEd failed to provide any metrics used to determine when and in what amounts restricted stock is awarded. Tr. at 702. CUB witness Smith explained that the program was restricted to directors, managers and select others who were paid in shares of Exelon (ComEd’s parent company) stock. The costs of Exelon stock are related to Exelon’s performance. CUB Ex. 1.0 at 43-46; CUB Ex. 3.0 at 15-18. Stock compensation aligns the interest of its recipients with the goal to maximize shareholder value – revealing the program’s purpose to further the financial and operation success of Exelon. However, the applicable legal standard requires a benefit to ComEd customers – a benefit that ComEd has failed to carry its burden to prove. ComEd claims that the program is in line with

industry practices, yet provides no legal support for the proposition that industry practice is the appropriate legal standard. The Commission has previously disallowed the cost of this program, rejecting ComEd's reach to find a benefit to ratepayers in "incentiviz[ing] management," here advanced as being "designed to retain key managers." ICC Docket 10-0467, Final Order at 65; ComEd Corr. Init. Br. at 60. 100% of the costs for this program should be disallowed here as well.

**c) Incentive Compensation**

The Company's costs of \$26.101 million for its Annual Incentive Program ("AIP") are only recoverable if it demonstrates a tangible benefit to ratepayers, subject to a prudence and reasonableness test. ICC Docket No. 07-0566, Final Order at 61; 220 ILCS 5/16-108.5(c)(4)(A). Mr. Smith recommended that ComEd's recovery of AIP costs be limited to 100% of target goals, be reduced by the amount increased by the CEO discretionary feature, and be reduced by 75% of the amount of costs related to Exelon Business Services Company ("BSC").

ComEd admits that the Commission has adjusted AIP amounts to 100% of target in previous rate filings. ComEd Ex. 13.0 at 24. Indeed, ComEd's own practice is to request recovery at the target level. ComEd Response to Staff Data Request TEE 6.05, included in CUB Ex. 1.3. ComEd failed to carry its burden to prove why the Commission should depart from this practice and allow higher percentages of recovery than the Company would have recovered from filing annual rate cases.

ComEd claims that AIP amounts above 100% of target are reasonable and prudent because of their effect on employee performance. ComEd Corr. Init. Br. at 64. ComEd fails to mention, however, that this Commission has considered such benefits from AIP before and has allowed recovery of AIP costs up to 100% of target. ICC Docket 10-0467, Final Order at 65. In

this case, ComEd leadership recommended that the net income limiter on the AIP plan be adjusted to increase the ultimate payout in 2010 to 112.1 % of goal. The increase in AIP costs resulting from this discretionary increase should be borne solely by shareholders. Allowing the CEO discretionary feature to increase the limitation defeats the ratepayer protection afforded by the net income limiter.

Expenses charged to ComEd by BSC that is tied to earning-per-share (“EPS”) goals should be excluded. ComEd admitted that 75% of the BSCP AIP expenses charged to ComEd were tied to the EPS goal. ComEd Response to AG 6.08(e), included in CUB Ex. 1.3. The PUA provides that “[i]ncentive compensation that is based on net income or an affiliate’s earning per share shall not be recoverable.” 220 ILCS 5/16-108.5(c)(4)(A). ComEd claims that the scrutiny provided to affiliate transactions under Section 7-101 of the Act provides sufficient ratepayer protection. ComEd Corr. Init. Br. at 62. This argument ignores the differing standards under Section 7-101 and under the provisions at issue in this docket – one judges the reasonableness of contract terms and the other judges the reasonableness of costs. ComEd cites no legal authority suggesting that prudence and reasonableness review under Article 16 is co-terminus with the approval of transactions under Article 7. ComEd asks that the Commission treat BSC like any other vendor, wholly ignoring the plain language of the Act barring recovery for incentive compensation “based on net income or an affiliate’s earning per share.” The Company attempts to render this language meaningless by claiming that this provision simply reflects Commission policy to limit recovery of public utilities, not of affiliates. *Id.* at 63. This disingenuous argument, of course, overlooks the word “affiliate” apparent on the face of the law. Incentive compensation based on net income or affiliate earnings induces managers to build earnings beyond the authorized level, creating conflict with ComEd’s obligation to serve ratepayers at

lowest feasible cost. The Commission should exercise extra scrutiny when determining the prudence and reasonableness of these costs.

**d) Perquisites and Awards**  
**i. Retention Awards**

ComEd's 2010 retention awards expense is not a reasonably normal and recurring expense, but rather an isolated event to pay a group of awards originating in 2007. The \$4.28 million in 2010 significantly exceeded the combined total of the previous three years - \$2.621 million. Especially given the severe recession and high unemployment of 2010, Mr. Smith testified that it was improper to recover exceedingly high retention awards. In recessionary periods with high unemployment, normal compensation is adequate to retain qualified personnel. Instead, Mr. Smith testified that the 2010 allowance for retention bonuses should be limited to a four-year average normalized amount. ComEd argues that it is unnecessary to normalize the 2010 amount on a four year average because customers benefit from a higher level of service and because no principled basis exists to limit recovery to 50%. *Id.* at 67. These arguments do not offer any explanation of why the 2010 costs – which significantly exceed the combined three previous years – are a prudent or reasonable amount.

**ii. Other Perquisites and Awards**

As explained in CUB-City's Initial Brief, Exelon's "Reward and Recognition Policy" rewards employee contributions to Exelon's success, thus it is appropriate to reflect a 50/50 sharing of those performance based awards. The prudence and reasonableness of customers sharing any more of that expense is questionable given that the Policy may be modified at any time, for any reason, at management's sole discretion.

**f) Charitable Contributions**

Mr. Smith adopted Staff witness Mr. Tolsdorf's recommendation to allow recovery from ratepayers for only those contributions that meet a strict interpretation of the statute and are within ComEd's service territory (allowing for recovery of \$2.916 million). Mr. Smith noted that charitable contributions are unnecessary to provide safe and adequate utility service, and that the goals of some organizations that ComEd chooses to donate to may conflict with the wishes of ratepayers. ComEd offers a different definition of "public welfare," and believes that because Section 9-227 is "general welfare" legislation it must be liberally construed. ComEd Corr. Init. Br. at 71. To be clear, Article 9 of the PUA requires that only prudent and reasonable expenditures that benefit utility ratepayers are recoverable. Despite ComEd' protestations that the organizations it chooses are worthwhile and will suffer if ComEd's contributions are disallowed, a ComEd affiliate named PECO recovers *no* donations from ratepayers yet makes contributions in amounts similar to ComEd. In ComEd's last rate case, the Commission disallowed contributions made to organizations outside the Company's territory because there was no evidence of tangible benefit to ComEd ratepayers. ICC Docket 10-0467, Final Order at 108. The Commission should find the same here.

**3. Taxes Other Than Income, Including Property Taxes**

ComEd proposes a different method of tax allocation than was used in its last rate case. CUB Ex. 1.0 at 57-58; CUB Ex. 3.0 at 39-40. This change increases expenses but ComEd provides no justification for the change. ComEd claims that the new methodology allocates taxes the same way they are allocated at FERC. ComEd Corr. Init. Br. at 76. ComEd believes that the Commission retains the flexibility to deal freely with situations as they come before it, subject to the bounds of reasonableness and to decisions that are not arbitrary and capricious. *Id.*

at 77. ComEd provides no legal authority for the proposition that consistency with FERC methodology is enough to meet its burden of proof required to change the methodology adopted in the last rate case. ComEd argues that this new method is reasonable because it results in full cost recovery and because its own witness believes that the old method produced a less accurate jurisdictional allocation. *Id.* at 78. ComEd’s own opinion of the matter notwithstanding, the Company has failed to carry its burden of proof to explain why a “more accurate jurisdictional allocation” is a reason for the Commission to depart from past practice.

#### **4. Regulatory Asset Amortization: IEDT**

ComEd recorded three years of Illinois Electric Distribution Tax Credits (“IEDT”) in 2010, yet it proposes to normalize that expense over five years. CUB Ex. 1.0 at 49-51; CUB Ex. 3.0 at 27-30. Although ComEd claims that its five-year proposal originates in Section 16-108.5(c)(4)(f) of the Act, that provision contains no requirements to normalize IEDT over five years. ComEd Corr. Init. Br. at 79.

[A]mortization over a 5-year period of the full amount of each charge or credit that exceeds ... \$10,000,000 for a participating utility that serves more than 3 million retail customers in the applicable calendar year ***and*** that relates to a workforce reduction program’s severance costs, changes in accounting rules, changes in law, compliance with any Commission-initiated audit, or a single storm or other similar expense, provided that any unamortized balance shall be reflected in rate base.

220 ILCS 5/16-108.5(c)(4)(f) (emphasis added).

The General Assembly’s use of the conjunctive “and” indicates that it only intended five-year amortization for costs incurred due to (1) workforce reduction program severance; (2) changes in accounting rules; (3) changes in law; (4) compliance with Commission initiated audits; or (5) a single storm or other similar expense. Because the IEDT amounts recorded by

ComEd in 2010 are for three years of credit and do not fall into any of the five enumerated categories, these amounts should be amortized over three years.

## **VII. COST OF SERVICE AND RATE DESIGN**

### **B. Rate Design, Including Upcoming Docket**

ComEd takes issue with Staff witness Peter Lazare's argument that the utility's rate design for the residential and watt-hour classes in this case is consistent with the Commission's Order in Docket 10-0467, ComEd's most recent traditional rate case. ComEd Corr. Init. Br. at 107-109. In that case, the Commission adopted ComEd's proposal to use a straight-fixed variable ("SFV") rate design. ICC Docket 10-0467, Final Order at 231-32. However, the Commission rejected ComEd's recommendation that a SFV rate design be implemented gradually such that at first 60%, then 70%, and finally 80% of the utility's *total* delivery service costs be recovered through the fixed charge portion of residential and watt hour customers' rates. Instead, the Commission directed "that the use of volumetric charges be reduced so that they recover 50% of *fixed* delivery service costs." *Id.* at 232 (emphasis added). The necessary corollary of the Commission's statement is that 50% of "*fixed* delivery costs" be recovered through fixed charges.

The dispute between ComEd and Staff is whether in its statement the Commission meant that 50% of "*fixed* delivery service costs or 50% of the utility's "*total*" delivery service costs should be recovered through the fixed portion of residential and watt hour customers' rates. Staff takes the Commission's statement at face value, arguing that the ICC intended that 50% of the *fixed* costs be recovered through the fixed charge component. Staff Init. Br. at 92. ComEd, on the other hand, takes a more impressionistic view of the Commission's words, claiming that Mr. Lazare takes the Commission's statement out of context and that the Commission intended that 50% of *total* delivery service costs be recovered through the fixed charge component.

ComEd Corr. Init. Br. at 107-108. CUB-City agree with Staff that ComEd's interpretation of the Commission's Order in Docket 10-0467 is incorrect and should be rejected.

ComEd engages revisionist history in making its argument. In this case, ComEd claims that Staff's interpretation of the sentence at page 232 of the Commission's Order in Docket 10-0467 is "inconsistent with the Order's approval of a design that moves away from recovery of fixed costs through volumetric charges, and ascribes an incorrect meaning to that sentence standing alone." *Id.* at 107. However, in its Brief on Exceptions and its Application for Rehearing in Docket 10-0467, ComEd took the contrary position; that is, the utility interpreted the statement from the Docket 10-0467 Order the same way that Mr. Lazare and Staff did in this case.

In its Brief on Exceptions, ComEd stated, "However, as adopted in the Proposed Order, the 50% SFV rate design appears to only apply to *fixed* costs, not to *total* delivery costs.<sup>3</sup> ICC Docket 10-0467, ComEd Br. on Excep. at 92 (emphasis added)(an excerpt of ComEd's Brief on Exceptions in Docket 10-0467 is attached to this brief as Attachment A).

At least in its Brief on Exceptions, ComEd stated that "it appears" the Proposed Order meant that the SFV rate design applied to only "*fixed*" costs. In its Application for Rehearing, ComEd conceded that there is no doubt that that was the case. There, ComEd argued:

The Order (at 231-32) errs in concluding that SFV should only apply to 50% of *fixed* delivery costs, because the Order's analysis clearly supports ComEd's original proposal to recover in fixed charges 60% of *total* Commission-approved delivery costs in the first year, 70% in the second year, and 80% thereafter.

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<sup>3</sup> The statement in dispute here is identical in the Proposed Order and the Commission's Order in Docket 10-0467.

ICC Docket 10-0467 ComEd App. for Reh. at 28-29 (citations omitted) (emphasis added)(an excerpt of ComEd's Application for Rehearing in Docket 10-0467 is attached to this brief as Attachment B.<sup>4</sup>

These statements make clear that ComEd understood the plain meaning of the Commission's words in the Order in Docket 10-0467. In Docket 10-0467, ComEd, as Staff does here, interpreted the Commission's statement to mean that the SFV rate applied only to *fixed* costs. It is disingenuous at best for ComEd to now take the position that Staff misconstrues the Commission's Order in Docket 10-0467.

ComEd also argues that even if the Commission intended that the SFV rate apply only to 50% of *fixed* costs, its compliance tariffs in that case used 50% of *total* delivery service costs. ComEd Corr. Init. Br. at 107. As Staff points out in its Initial Brief, ComEd's argument implies that there is some sort of statute of limitations associated with rectifying ratemaking errors. Staff Init Br. at 93. CUB-City are not aware of any such statute of limitations, nor does ComEd cite to any legal authority for this proposition. Rather, the more reasonable approach is to do as Staff (and AG-AARP) recommends -- to correct the error that was made in ComEd's compliance tariffs in Docket 10-0467 in this case.<sup>5</sup> *Id.* at 91-98; AG-AARP Init. Br. at 61-65. That is, the Commission should adopt Staff's proposed charges for the residential and watt hour classes.

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<sup>4</sup> While the text in Attachments A and B is identical to the text in ComEd's Brief on Exceptions and Application for Rehearing in Docket 10-0467, respectively, the layout of the pages changed during the conversion process.

<sup>5</sup> A more troubling interpretation of the sequence of events in Docket 10-0467 is that although ComEd understood the Commission's Order to mean that the SFV rate should apply to 50% of *fixed* delivery service costs -- as its Brief on Exceptions and Application for Rehearing indicate -- the utility chose to apply its preferred 50% of *total* delivery service costs to the SFV rate.

## **VIII. ADDITIONAL FORMULA/TARIFF ISSUES**

### **C. Reconciliation**

#### **1. Average Rate Base Proposals (see also III.C.1)**

CUB-City, Staff, AG-AARP and IIEC all demonstrated that in reconciliations going forward, the rate base calculation should be based on an average rate base for the calendar year being reconciled rather than the year-end rate base recommended by the Company. ComEd's most prevalent argument as to why year-end rate base is appropriate to use in the reconciliation calculation is the timing of reconciliations. ComEd Corr. Init. Br. at 115-116 ("The proposal is behind the times, at every step...When the timing under the formula rate process discussed above is considered, it is obvious that the 'average rate base' proposal is wrong"). This argument is deficient. ComEd seeks to overstate its revenue requirement in reconciliations and collect from its ratepayers for a rate base—and a return on that rate base—that is not reflective of the plant actually in service for the entire year.

ComEd stands alone in its interpretation of the PUA. As Staff pointed out, the Act does not specifically state that either year-end or average rate base should be used in determining the reconciliation revenue requirement, but is specific and consistent that actual cost information for the applicable calendar year must be used. Staff Init. Br. at 100. ComEd listed four specific arguments that it asserted support use of a year-end rate base. First, ComEd notes the Act's requirement that the reconciliation rely on FERC Form 1 data. ComEd Corr. Init. Br. at 115. However, ComEd admitted that the year-end balance reported on its FERC Form 1 is not representative of plant that was actually in service during the entire year. Tr. at 944. Therefore, relying solely on year-end data from the FERC Form 1 does not yield a revenue requirement based on actual cost information for the applicable calendar year.

Next, ComEd argues that use of year-end rate base is consistent with traditional ratemaking principles, because the formula rate process is akin to a historical test year where a year-end rate base is used. ComEd Corr. Init. Br. at 116. However, as IIEC pointed out, ComEd's lead witness was clear that "test year rules have little or no remaining application in the annual formula ratemaking world." ComEd Ex. 11.0 at 6.

Third, ComEd argues that regulatory lag continues to exist in the formula rate process, and the average rate base proposal perpetuates cost under-recovery. ComEd Corr. Init. Br. at 116. This argument is a fallacy, as it assumes that the formula rate process must eliminate regulatory lag as much as possible. ComEd provided no citation or other support for that notion. The purpose of the formula rate legislation was not to provide a participating utility with the highest possible recovery. Rather, EIMA stated that the General Assembly favored modernization of the State's electric grid, and found that regulatory reform measures that increase predictability, stability, and transparency in the ratemaking process were needed to promote that investment. Public Act 97-0616 § 108.5(a). Requiring that rate base be calculated based on average year rate base rather than year-end rate base is predictable, stable and transparent, and ensures that only the utility's actual costs are recovered from ratepayers.

ComEd's fourth and final argument is that the way "the process actually works" will prevent ComEd from over-earning the intended return on equity. ComEd Corr. Init. Br. at 116. That argument is also a fallacy, based on the assumption that rate base is correctly calculated if based on year-end rather than average year figures. Given the statutory formula for determining ComEd's cost of equity (220 ILCS 5/16-108.5(c)(3)), if the Company's rate base is over-recovered, its rate of return will be too. The parties to this case have shown that will be the case if year-end rate base is used in reconciliations.

## **2. Interest Rate Proposals**

ComEd's only comment on the CUB-City proposal that carrying costs on over-collections by ComEd should be computed at the larger of (1) ComEd's overall cost of capital or (2) ComEd's short term debt cost is that it is asymmetrical, one-sided and unprincipled. ComEd Corr. Init. Br. at 118. This argument has already been rebutted by Mr. Smith, who explained that his recommendation is based on the sound regulatory principle of protecting ratepayers from utility over-projections of plant growth and utility omissions of offsetting factors, such as tax savings benefits. CUB Ex. 3.0 at 33-34. CUB-City's proposal protects ratepayers from manipulation of projected plant addition amounts by ComEd, and from intentional over-collections that result from ComEd ignoring substantial known impacts that should be subject to reasonable estimation, such as the 2011 bonus tax depreciation discussed in Section III.C.5.a above. ComEd can produce over-collections simply by over-projecting its plant additions or not including offsetting factors. Requiring a higher interest rate for over-collections will thus provide an appropriate and necessary deterrent to ComEd from making over-projections of plant additions. Additionally, allowing interest on under-collections based on the lesser of the short-term debt rate and ComEd's overall weighted cost of capital, will also encourage the Company to make accurate projections of plant additions, because its earnings on under-collected balances resulting from misprojecting plant additions would be at the lower of those rates.

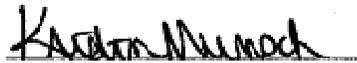
Staff witness Ebrey presents another reasonable approach to calculating the interest rate on under-collections. If the customer deposit rate is to be used for the reconciliation, the carrying costs on over-collections by ComEd should then be computed at the larger of (1) ComEd's overall cost of capital or (2) ComEd's customer deposit interest rate.

**X. CONCLUSION**

The Commission should adopt the recommendations discussed herein and in the CUB-City Initial Brief. The Commission should exercise its continuing authority in this formula rate environment, including the alignment of infrastructure investment and proposed expenses with improved utility performance, and should lower ComEd's delivery services rates to match its actual expenses.

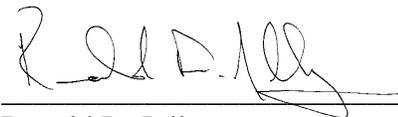
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