ComEd Ex. 21.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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

Surrebuttal Testimony of

KATHRYN M. HOUTSMA, CPA

Vice President,

Regulatory Projects

Commonwealth Edison Company

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I. Introduction and Purpose

A. Identification of Witness

Q. What is your name and business address?

A. My name is Kathryn M. Houtsma. My business address is Commonwealth Edison Company, Three Lincoln Centre, Oakbrook Terrace, Illinois 60181.

Q. Are you the same Kathryn M. Houtsma who submitted direct and rebuttal testimony on behalf of Commonwealth Edison Company ("ComEd")?

A. Yes.

B. Purpose of Testimony

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to certain rebuttal testimony of the following witnesses: Illinois Commerce Commission Staff ("Staff) witnesses Theresa Ebrey, Richard Bridal, Steven Knepler, and Philip Rukosuev, Attorney General/AARP ("AG/AARP") witness Michael Brosch, Citizens Utility Board ("CUB") witness Ralph Smith, and Illinois Industrial Energy Consumers ("IIEC") witness Michael Gorman.

C. Identification of Exhibits

Q. What exhibits are attached to and incorporated in your surrebuttal testimony?

A. The following is a list of the exhibits attached to my surrebuttal testimony and a brief description of each:

1. **ComEd Exhibit ("Ex.") 21.1** is 33 pages in length and consists of the blank spreadsheets in determination of the annual revenue requirement for Rate DSPP

and a summary of the changes made or agreed to by ComEd in the formula since the filing of rebuttal testimony.

2. **ComEd Ex. 21.2** is two pages in length and compares ComEd's 2010 pension and other post-employment benefit costs to those for 2011. This was provided in ComEd's Data Request Response to TEE 1.05.

3. **ComEd Ex. 21.3** is 23 pages in length and consists of ComEd's FERC transmission formula rate. This was provided in the attachment to ComEd's Data Request Response to AG 1.03, labeled as AG 1.03_Attach 1.

4. **ComEd Ex. 21.4** is one page in length and compares the functionalizing of general and intangible plant using a wages and salaries allocator to the allocation of costs using the methods proposed by Staff.

These exhibits have been prepared by me or under my supervision. To the best of my knowledge and belief, they are accurate.

D. <u>Summary of Conclusions</u>

Q. **Please summarize the conclusions in your surrebuttal testimony.**

A. In summary, I conclude as follows:

1. The pension funding adjustment recommended by Ms. Ebrey should be rejected. Allowing a debt return on the pension asset is consistent with Illinois Commerce Commission ("ICC" or "Commission") practice and law, complies with the relevant accounting guidelines, and is the appropriate ratemaking treatment to be applied to ComEd's investment. Ms. Ebrey's proposal is none of these.

2. Ms. Ebrey's pension cost adjustment is also improper and should be rejected. The expense reductions that Ms. Ebrey seeks to include are not properly considered in

2010 and will instead be properly accounted for when all of ComEd's 2011 costs are reviewed in the reconciliation.

3. In accordance with Mr. Bridal's adoption of the alternative approach to accumulated depreciation and depreciation expense adjustments set forth in my rebuttal testimony, this approach (with minor modifications to properly reflect jurisdictional adjustments) should be accepted.

4. Mr. Bridal's position to include non-AFUDC CWIP in rate base only when actual costs are considered in the reconciliation proceeding is reasonable and should be accepted.

5. Mr. Knepler's proposed changes to the wages and salaries allocator should be rejected because the overhead costs at issue are more appropriately recovered as a delivery service charge.

6. Mr. Rukosuev's criticisms of the General and Intangible Plant functionalization using the wages and salaries allocator are unwarranted and should be rejected. The wages and salaries allocator is cost based for the accounts at issue, more so than a plant based allocator, and aligns with the methods used at FERC.

7. Mr. Brosch's opposition to ComEd's use of the Net Plant allocator to allocate property taxes should be rejected because the methods ComEd proposes to use not only align better with FERC, they are a more reasonable measure of the overall investments in transmission and distribution.

8. Mr. Bridal, Mr. Brosch, and Mr. Gorman's positions on average rate base should be rejected because the Public Utilities Act does not call for use of averages and

indeed contemplates end of year data. Moreover, the formula rate is not analogous to a future test year and does not eliminate regulatory lag.

9. Ms. Phipps' recommendation that the Commission adopt the customer deposits interest rate on the true up value, and Mr. Brosch and Mr. Gorman's similar arguments in favor of a short term debt interest rate, should be rejected because they do not represent actual costs or would represent a double count.

10. Mr. Gorman's recommendation for a separately presented earnings collar is unnecessary and should be rejected because it is already separately presented and would unduly complicate the interest calculation.

II. <u>Pension Funding Adjustment</u>

Q. **Ms. Ebrey states that in Docket No. 05-0597, the Commission agreed with Staff that ComEd did not have a pension asset, made no contrary finding in its Order on Rehearing, and has not deemed ComEd to have a pension asset in any subsequent delivery rate case. Is this a correct characterization?**

A. No. While the Commission's original order in Docket 05-0597 accepted Staff's position that ComEd did not have a pension asset and allowed no return in that proceeding, that is irrelevant in light of the Order on Rehearing which reached an entirely different conclusion. The plain language of the Commission's Order on Rehearing in Docket No. 05-0597 contradicts Ms. Ebrey's claim that the rehearing order did not make a finding of a pension asset. That order states: "[T]he Commission approves cost recovery of the <u>Pension Asset</u> under Alternative 3 that ComEd proposed on rehearing." *Commonwealth Edison Co.*, ICC Docket No. 05-0597, Order on Rehearing (Dec. 20, 2006) at 28 (emphasis added). Under Alternative 3, ComEd recovered the costs of its pension contributions through an adjustment to operating income equal to a debt return on the pension asset recorded on its books net of accumulated deferred income taxes. Although there have been some variations with respect to the calculation of cost recovery, some form of recovery for those same costs has been allowed in every ComEd rate case since that time.

Q. **Do the lengthy excerpts of past ComEd distribution rate orders provided by Ms. Ebrey support her contention that the Commission does not have a "long-established" practice of allowing the recovery of the costs of ComEd's pension contributions?**

A. No. In fact, they demonstrate precisely the opposite – namely that the Commission granted ComEd some form of return on its pension contributions in each of its distribution rate orders since 2005. In Docket No. 05-0597, ComEd recovered $25.3 million. Staff Ex. 13.0, 7:173-8:174. In Docket No. 07-0566, the Commission allowed $25.1 million. *Id.* 8:179-82. In Docket No. 10-0467, ComEd recovered approximately $25 million related to amounts that are reported on ComEd's balance sheet and in its FERC Form 1. Ms. Ebrey disputes whether the Commission has labeled these contributions "pension assets," but regardless of whether they are called assets, contributions or deferred debits, the underlying investment on which the return was allowed is the same investment that is at issue here. It is indisputable that the Commission's established practice in ComEd's distribution rate proceedings has been to grant cost recovery of amounts that ComEd appropriately reports as pension assets. Since ComEd first reported a pension asset on its audited financial statements in 2003, the Commission has never deemed the appropriate amount of cost recovery associated with ComEd's reported pension asset to be $0, which is what Ms. Ebrey proposes in her adjustment.

Q. Ms. Ebrey cites Commission orders in various dockets of Peoples/North Shore and Nicor as further support for her contention that a pension asset should not be given rate base treatment. What is the relevance of those orders in this proceeding?

A. They are not relevant. First, while I am not an expert about the financial circumstances or accounting details of the pension contributions of those companies, it is clear that the Commission has considered the individual circumstances for ComEd as well as Peoples/North Shore and Nicor and has consistently allowed some form of return to ComEd on its pension asset and has consistently not allowed a return on the pension asset in the case of Peoples/North Shore and Nicor. The ratemaking considerations for those companies are different from those in the case of ComEd because, as ComEd has previously testified, the facts are different. Also, the Energy Infrastructure Modernization Act, pursuant to which this proceeding has been initiated, states that ComEd is entitled to earn a return on pension assets net of deferred tax benefits equal to its long-term debt cost.

Q. How do you respond to Ms. Ebrey's claim that her adjustment takes into account the status of the pension plan on a stand-alone basis and that ComEd's position rests solely on the mechanics of accounting?

A. Ms. Ebrey's adjustment seems to do the opposite. The stand-alone basis of ComEd's pension plan is reported on its audited financial statements and reflects a pension asset of $1.039 billion. *See* ComEd Ex. 12.2. The pension asset reported on ComEd's financial statements consists of the net amount of the cash contributions made by ComEd to the pension fund, and the liability consisting of the amounts collected from customers through rates as periodic pension expense. Ms. Ebrey suggests that a host of other adjustments should be made to this "stand-alone basis," including consideration of accounting entries related to the pension plan recorded on Exelon's financial statements. William Graf of Deloitte & Touche (ComEd Ex. 14.0) testified on rebuttal that ComEd's pension accounting is customary and proper and that the adjustments proposed by Ms. Ebrey are not required or proper, and that Ms. Ebrey's conclusion that ComEd does not have a pension asset is wrong. Graf Reb., ComEd Ex. 14.0, 5:102-06. Moreover, even if the accounting entries were recorded on ComEd's books, rather than Exelon's, there would be no economic basis to reduce the revenue requirements by those amounts.

Q. **Why would it not be appropriate to take a "broader view" and consider the items Ms. Ebrey references in the determination of pension asset?**

A. First, as Mr. Graf testifies, the manner in which the pension plan is accounted for on ComEd's books is appropriate. Second, even if, hypothetically, the accounting entries necessary to record the full funded status of the pension plan were to be recorded on ComEd's books, the mere recording of the journal entries does not mean that rates should be impacted. The items that Ms. Ebrey references are valuation entries and should not affect cost-based rates. For example, Ms. Ebrey suggests that the accounting entry on the plan sponsor's books to recognize the current fair value of the assets in the pension plan trusts should be recognized in the formula rate calculation, although this would be completely contrary to the concept of original cost ratemaking. None of ComEd's other assets are recognized at fair value, nor should they be, and it would be counter to the concept of original cost ratemaking to consider the investment in the pension plan any differently than other investments.

Q. **How do customers receive the benefit of increases in the fair value of pension plan assets, if those changes are not reflected in the investment value?**

A. The fair value of the plan assets can be very volatile, and accounting for pension costs recognizes those changes in value gradually through periodic pension costs. The Commission's long-standing practice has been to provide for recovery of pension costs based on FAS 87/ASC 715, a treatment which smoothes out any changes in fair value over extended periods of time. Ms. Ebrey's proposal to consider the changes in fair value in the annual ratemaking process would be a significant departure from past practice.

Q. **Ms. Ebrey also suggests considering the total amount of the pension benefit obligation in the calculation of the pension asset, rather than an amount based on the cumulative amount of periodic pension costs. Do you believe it is appropriate to consider these amounts for ratemaking purposes?**

A. No. Irrespective of whether these costs are recorded on ComEd's books, there is no basis to consider this accounting obligation in ratemaking calculations. The past ratemaking practice of recognizing the obligation based on the cumulative amount of annual pension costs recovered through rates is logical because it is a measure of the funds provided by customers to satisfy that obligation. The difference between the total amount of the pension benefit obligation that Ms. Ebrey cites, and the cumulative amount of obligation considered by ComEd in the determination of the pension asset is attributable to actuarial gains and losses (currently net losses due in large part to changes in trust fund values) that have not been recognized in periodic pension expense. Because these gains and losses have not been recognized in periodic pension expense they have not been collected from customers. Therefore this liability does not represent a source of capital or customer supplied funds and hence there is no principled basis to consider it in ratemaking.

Q. **If the net funded status (*i.e.*, the fair value of the plan assets less the pension benefit obligation) were to be recorded on ComEd's books are there any other assets that would also be recorded?**

A. Yes. The net effect of recording these accounting entries is offset by the recording of a regulatory asset. This is true both at Exelon as it is accounted for today and hypothetically if the funded status were to be recorded at ComEd. The regulatory asset is a recognition that the actuarial gains and losses and changes in fair value of the trust fund have not yet been recorded as period pension costs (or recognized in rates) but will be in future periods and will flow through customer rates in future periods. When the funded status and the regulatory asset are considered together the net effect is zero, and the net amount of the pension asset for ratemaking purposes should remain the same. Again, however, those accounting entries should have no bearing on the ratemaking formula as they do not represent funds that customers have provided to ComEd through rates or the amount of funding that ComEd has invested in the pension fund to date. Ms. Ebrey's "broader view" is far too broad in that it gives no consideration to the economic substance of the entries.

Q. **Ms. Ebrey either states or quotes Commission orders at several points that premise cost recovery on the extent to which there was a "ratepayer benefit" resulting from the contribution.[1] Has ComEd provided evidence of the benefits to customers of these contributions?**

A. Yes, and they are much greater than the cost recovery provided for by law and included by ComEd in its revenue requirement. The pension contributions made by ComEd from 2003 to 2009, the basis for the pension funding costs in the revenue requirement, reduced jurisdictional pension expense by $61.0 million in 2010 relative to what it would have been had the contributions not been made. In comparison, the funding cost of those pension contributions in 2010 is only $34.9 million. *Compare* ComEd Ex. 12.3, *with* Fruehe Reb., ComEd Ex. 13.1, Sched. FR C-3. Therefore, even if the statute conditioned the recovery of a debt return on the pension asset on the showing of a customer benefit (which it does not), the benefits here clearly outweigh the cost. In addition, significant non-monetary customer benefits arise out of funding the pension plans, specifically the ability to attract and retain a skilled workforce that is confident in uncertain economic times that its employer is properly providing for employees' promised post-retirement income.

Q. **Ms. Ebrey states that since Section 16-108 of the Public Utilities Act does not define the term "pension asset," the Commission should determine for itself what that term should mean for ratemaking purposes. Do you agree?**

[1] See, for instance, Ebrey Reb., Staff Ex. 13.0, 5:98-99, 6:127-29, 7:154-56, 9:221-23, and 10:236-37.

A. Like Ms. Ebrey, I am not an attorney. However, the Illinois General Assembly specifically stated that utilities are entitled to recover through a formula rate the funding costs of their pension assets by earning a debt return on a pension asset net of deferred taxes and that the costs in the formula rate should be derived from the FERC Form 1, with limited express exceptions not applicable here. ComEd's FERC Form 1 has a line item that reports a "Pension Asset." See ComEd Ex. 12.2, page 2. This is similar to the treatment that these investments have been accorded by the Commission in the last three cases, as I mentioned. To suggest that the Commission should determine *de novo* what the term "pension asset" means in a manner that would represent a complete reversal from how costs have been treated in three consecutive rate orders, or that the General Assembly contemplated that the Commission *should* or *must* do that, and to consider accounting entries that are not included on any page or line item in the FERC Form 1 is specious. The legislature's intention in terms of recovery of pension funding costs is clear.

Q. **Are there not certain instances where ComEd's proposed formula references source documents other than the FERC Form 1?**

A. Yes. But the distinction here is that in those instances the reason a different source item is required is because the cost is not separately aggregated or disclosed on a stand-alone basis in the FERC Form 1, *i.e.*, it is aggregated into or is a subset of a cost or line item that is in the Form 1. In this case the items Ms. Ebrey proposes to consider are not represented anywhere in the FERC Form 1 because they are not recorded on ComEd's income statement, balance sheet or capital structure.

Q. **Ms. Ebrey claims that pension costs should be calculated on a "stand-alone" basis, comparable to the calculation of income taxes. Is the pension asset as presented by ComEd calculated on a stand-alone basis?**

A. Yes. I agree that income tax calculations are performed on a stand-alone basis, and I would note that income tax calculations reflect only the costs and revenues recorded on ComEd's financial statements, and do not consider costs recorded on affiliates' books. It is Ms. Ebrey's position that would reach outside of ComEd's books to consider costs that are recorded on an affiliate's books, while ComEd's position only considers costs that have been reflected on its books. Moreover, as I described earlier, even if, hypothetically, Exelon were not the plan sponsor and the accounting entries to reflect the full funded status were recorded on ComEd's books, there would still be no net effect due to the offsetting nature of the entries and the impropriety of including those entries in the ratemaking equation.

III. Pension Costs

Q. **Ms. Ebrey maintains her claim that it is appropriate to reduce ComEd's pension expense by $9.977 million to reflect the cost of the pension contributions made in 2010. How do you respond to her argument?**

A. Ms. Ebrey's adjustment would result in an under-recovery of pension expense. ComEd's revenue requirement reflects pension and post-retirement benefit expense booked in 2010 and supported by actuarial reports. *See* Fruehe Dir., ComEd Ex. 4.10. This proceeding will set rates effective for June to December 2012. The legislation states that these rates are based on the utility's actual costs for 2010 plus projected plant additions and corresponding depreciation reserve and expense for 2011. If Ms. Ebrey's adjustment is adopted, ComEd will recover less than its actuarially-determined costs for 2010, which is what the law authorizes ComEd to include in rates, over the period from June to December 2012.

Q. **Did ComEd's 2010 pension contributions lower 2010 pension expense?**

A. No. As stated in my rebuttal testimony, ComEd's 2010 pension expense was determined by the actuaries in March 2010 and did not take into account these contributions because they had not yet been made.

Q. **When will the 2010 pension contributions affect pension expense?**

A. ComEd's actuarial consultant measured these costs in March 2011 and they will be reflected in ComEd's FERC Form 1 for 2011. This will be the basis of the updated costs reflected in the filing ComEd will make in May 2012. Assuming all other components of cost were constant, those pension contributions reduced ComEd's pension expense in 2011 by $9.976 million. See Ebrey Dir., Staff Ex. 1.0, Attachment E.

Q. **Did all of the other components of pension expense remain constant from 2010 to 2011?**

A. No. Each year, a host of the determinants of pension cost change including (but not limited to) the discount rate used to value future pension obligations, investment returns, and various actuarial data about ComEd's employee and retiree population. These same factors can affect the costs of other post-employment benefits (OPEB). Each of these components could increase or decrease expense if all other factors were equal. In fact, as shown in ComEd Ex. 21.2, ComEd's jurisdictional pension expense decreased by $9.968 million from 2010 to 2011. However, ComEd's jurisdictional OPEB expense, reported in the same actuarial measurement, increased by \$9.633 million. Ms. Ebrey's proposal to update one cost that she knows will decrease from 2010 to 2011 while ignoring other costs that offset that decrease is one-sided.

Q. **Considering all the factors, is it appropriate to reflect the overall reduction in pension expense in the current proceeding?**

A. No. The statute expressly provides which costs should be projected in the initial proceeding. To the extent that the actual pension costs in the filing year (in this case 2011) are lower than the actual data used (in this case 2010), the difference in the revenue requirement will be reflected in the following year's rates after the reconciliation proceeding, and interest will be credited as appropriate. The change in pension expense will be updated systematically at the same time as all other elements of the revenue requirement. It would not be appropriate to update for 2011 pension expense in this proceeding just as it is not appropriate to update for OPEB cost changes, or any other cost changes.

IV. <u>Accumulated Depreciation and Depreciation Expense Adjustments</u>

Q. **Did Staff or any other party respond to the alternative calculation of projected depreciation expense provided in Exhibit 12.5 to your rebuttal testimony?**

A. Yes. Staff witness Mr. Bridal adopted the alternative approach in his rebuttal testimony, and no other party raised any concerns or objections. Accordingly, we are adopting the alternative approach set forth in ComEd Ex. 12.5 (with a minor modification to properly reflect jurisdictional adjustments) and have included it in the formula template included as ComEd Ex. 21.1 attached to my testimony.

V. Non-AFUDC Construction Work in Progress (CWIP) in Rate Base

Q. ICC Staff witness Mr. Bridal continues to oppose the use of a year-end 2010 value for non-AFUDC CWIP in rate base because in his view the use of a proxy amount is not appropriate in a formula rate setting. Mr. Bridal does agree that it is appropriate to include non-AFUDC CWIP in rate base when actual costs are considered in the reconciliation proceeding. How do you respond to his position?

A. While I continue to believe that it is reasonable to include the prior year historical amount as a proxy value for the amount of non-AFUDC CWIP that is expected to be outstanding at the end of the following calendar year, I understand Mr. Bridal's position. I believe it is reasonable to include non-AFUDC CWIP in rate base only in the reconciliation when the actual amount is known and also reasonable, and that this should eliminate any concerns over the use of proxy values. Accordingly, ComEd Ex. 21.1 has been revised to remove CWIP in rate base from the current year revenue requirement but to include the amount in the rate base used for reconciliation purposes. *See* Mr. Hengtgen's surrebuttal (ComEd Ex. 25.0) for how the exclusion of non-AFUDC CWIP in rate base would affect ComEd's cash working capital requirements.

VI. Wages and Salaries Allocator

Q. Staff Witness Mr. Knepler asserts that ComEd's proposed wages and salaries allocator would overcharge delivery services customers by charging them for costs that he believes are not delivery related and claims that ComEd is indifferent as to what tariff and what customers pay for these costs. Is his characterization accurate?

A. No. It is certainly not ComEd's intent to overcharge customers, and ComEd's proposed calculation of the wages and salaries allocator does not do so. Although Mr. Knepler repeatedly makes the claim that ComEd is attempting to "overcharge" customers, it is not clear why he believes this has occurred. This is not a black and white issue where it is clear that the costs we are talking about (human resources, finance, injuries and damages, and numerous other general corporate costs) are production related. The costs at issue here are indirect overhead costs that by their very nature cannot be directly identified as either production (supply), transmission, or distribution costs. And to be clear, ComEd is not indifferent as to what tariff these costs should be recovered under. As stated in my rebuttal testimony, ComEd's position is that the overhead costs that Mr. Knepler would assign to the production (supply) function are more appropriately recovered as a delivery service charge.

Q. **Mr. Knepler claims that he is simply following the FERC Form 1 and that ComEd's proposed treatment suggests the FERC Form 1 is inaccurate. Is ComEd's FERC Form 1 inaccurate?**

A. No. ComEd's FERC Form 1 appropriately reports the $1,432,396 in salaries, wages, and associated pensions and benefits of employees engaged in the energy acquisition function in production related O&M accounts. These costs are recovered through Rider PE, not through delivery services rates, and ComEd is not proposing to change that. They are not at issue here. The question here is to what extent an additional $2.7 million in indirect overhead costs recorded in other accounts should be layered on top of those costs and attributed to these energy acquisition employees. In my view, these costs are incurred as a result of conducting ComEd's principal lines of business – transmission and distribution

– and should appropriately be split between those lines of business. The approach that has been followed in the past – to allocate to Rider PE the cost of the salaries and wages of employees directly engaged in energy acquisition, along with their pensions and benefits – is reasonable both in terms of result and ability to administer. The wages and salaries allocator proposed by ComEd in this proceeding is consistent with the calculation accepted in Docket No. 10-0467 and continues to be appropriate.

Q. **How did Mr. Knepler respond to your testimony that the $2.7 million of overhead costs should be recoverable through Rider PE if the Commission accepts his calculation of the wages and salaries allocator?**

A. Mr. Knepler's testimony was that it was possible that some costs could be shifted but that should be determined in another docket. In other words, Mr. Knepler is adamant that these costs should not be recovered in delivery services rates because they are related to the energy acquisition costs recovered through Rider PE, but he is non-committal as to whether they should be recovered through the tariff that recovers the energy acquisition costs. I would urge the Commission not to engage in a shell game whereby indirect overhead costs, which no party claims are unreasonable or imprudent, are continuously punted from tariff to tariff, leading to unnecessary litigation.

VII. <u>General and Intangible Plant Functionalization</u>

Q. **Staff witness Mr. Rukosuev testifies in rebuttal that you failed to produce any testimony demonstrating how the wages and salaries allocator that ComEd is proposing to use is calculated, nor did you provide any support to demonstrate that the wages and salaries allocator aligns with the method used in the FERC-jurisdictional Transmission Formula Rate. Have you provided any testimony to**

support the calculation of the wages and salaries allocator and the methodological alignment?

A. Yes. The calculation of the wages and salaries allocator was described in my direct testimony (ComEd Ex. 2.0, 10:205-09), and the actual calculation was initially set forth in ComEd Ex. 2.1, Sched. FR A-2, lines 1-9. I would note that the wages and salaries allocator is not only used to allocate various G&I plant Accounts, but also a number of other cost elements, in the same manner that has been done in the past as was approved by the Commission in prior Dockets. In other words, this is not a new and novel allocator that is being used for the first time in this proceeding and being applied solely to G&I plant (other than Account 397). In fact, Mr. Knepler has specifically filed testimony regarding the calculation, so it should not be considered a mystery as Mr. Rukosuev implies.

The FERC-jurisdictional Transmission Formula Rate was provided to Staff and parties in discovery in this docket, but in response to Mr. Rukosuev's testimony, I have also attached it to my testimony here as ComEd Ex. 21.3. The calculation of the wages and salaries allocator can be found on lines 1-5.

Q. **Mr. Rukosuev complains that you did not conduct an analytical evaluation to assess the appropriateness of functionalizing G&I plant (for Accounts other than the directly assigned Account 397) using wages and salaries allocators, and instead relied on judgment. How do you respond?**

A. As Mr. Rukosuev acknowledges, allocation methods unavoidably employ the exercise of judgment in instances such as this where there are no direct measures of cost causation. I would point out that although I have not, and cannot, perform any special analysis to quantitatively prove that a labor-based allocator bears a cost causation relationship to Accounts such as 394 (Tools), 395 (Lab Equipment), and 396 (Power Operated Equipment), it is also true that no such special analysis exists to support the use of a plant-based allocator that was previously used for these Accounts and that Mr. Rukosuev advocates. Further, although I have not performed studies, I have supported my position with my judgment that because employees, not plant, use the tools and equipment in these Accounts, a wages and salaries based allocator appears to bear a closer cost causation relationship than that of a plant based allocator. Mr. Rukosuev has not disputed this logic but instead has ignored it. *See also* my discussion of these Accounts in my direct and rebuttal testimony, and of Accounts 390 and 392 in my direct and rebuttal testimony and below.

Q. **Is Mr. Rukosuev's assertion that your only justification for recommending a change is alignment with FERC methodologies?**

A. No. I have discussed why the W&S allocator, while it is not the only possible method, is cost-based for the Accounts at issue. Moreover, in addition to the rationale described above for Accounts 395, 395, and 396, I have noted that the studies previously performed for Accounts 390 (Structures) and 392 (Transportation Equipment) were subjective and should not be considered precise, especially if not updated over time. Also because those studies did not indicate materially different allocation percentages, my opinion is that they did not justify the additional time and effort. These studies would also be more difficult and time consuming for Staff and intervenors to review and audit. Therefore, to the extent Mr. Rukosuev raised concerns about the ability of Staff to investigate alignment of the wages and salaries allocator, I would also think that it requires more resources to review and audit the reasonableness of the property usage studies and the transportation studies. In the end, the wages and salaries allocator results in relatively similar allocations as shown in ComEd Ex. 21.4, is based on a rational cost based methodology, and has the advantage of aligning with the transmission rate.

Q. **Mr. Rukosuev dismisses the advantage of aligning methods with the FERC approved transmission rate by stating that the Commission is not bound by FERC approved methods. How do you respond?**

A. I am not an attorney and know that the attorneys will address the legal arguments in briefing. However, I would observe that because the ICC-approved Rider PE provides for recovery of transmission service charges to retail customers based on the FERC-based transmission rates, achieving alignment of allocation methods should be a desirable goal for all parties.

VIII. Property Tax Allocations

Q. **AG/AARP witness Mr. Brosch continues to oppose ComEd's proposed allocation of property taxes. He acknowledges that inter-jurisdictional alignment between treatment of these items is desirable but suggests that you have presented no argument as to why the Commission should change the method ComEd previously utilized, and therefore suggests that ComEd should petition FERC, rather than the Commission to change methods. How do you respond?**

A. As stated in my rebuttal testimony, alignment with the FERC Transmission Formula Rate is not the only basis for utilizing different methods. In rebuttal, I explained that ComEd has compared the two methods and believes that the Communications Equipment allocator, which was previously used, is not appropriate for property taxes related to

Rights of Way and Substation property. ComEd Ex. 12.0, 31:676-90. ComEd now believes the overall Transmission and Distribution Net Plant allocator is a more reasonable measure for allocating real estate taxes than the allocator that results from the analysis of Communication Equipment, as the Net Plant Allocator better portrays the overall relationship between the overall investments made in transmission and distribution plant. *Id.* Because the Net Plant Allocator has a better cost causation relationship, ComEd does not believe it is appropriate to petition FERC for changes in the method of allocating property taxes. The Net Plant allocator has a better cost causation relationship, and it has the advantage of aligning with the FERC transmission rate, thereby assuring no gaps or overlaps in cost recovery.

IX. <u>Reconciliation Issues – Average Rate Base</u>

Q. Staff witness Mr. Bridal in rebuttal adopts the recommendation of other intervenor witnesses that an average rate base be used in the reconciliation, stating that he believes the term "actual" as used in the statute is synonymous with the word "average." Is that a reasonable conclusion?

A. No. In my opinion the statute was clear where it intended that averages be used, and there is no indication that the term actual was intended to represent an average. Further, the statute indicates that the reconciliation utilize cost data "as reflected in the applicable FERC Form 1 … for the prior rate year." 220 ILCS 5/16-108.5(d)(1). The fact that plant data for the year previous to the prior rate year which would be necessary to calculate an average rate base is published in the FERC Form 1 does not suggest that data for both years should be used. Further, it would plainly be inconsistent to reconcile a revenue requirement initially calculated assuming a year end rate base to a subsequent calculation based on an average.

Q. **Does the fact that the statute calls for use of data "for the applicable calendar year," rather than "as of the end of" the applicable calendar year suggest to you that an average rate base be used?**

A. No. Given that the revenue requirement includes operating expenses, which are incurred over the course of the calendar year, as well as investment, or rate base elements that are measured as of a point in time, it is only appropriate that the statute references the use of costs for the calendar year. It would not be feasible to indicate that costs as of the end of the year should be used because, unlike investment or rate base elements, operating expenses are not a point in time balance and by definition are considered for a period of time. I would also note that the formula appropriately recognizes that the investment is made gradually throughout the calendar year and provides for accumulation of interest on a monthly-weighted average basis in the first applicable year. If the Commission were to accept the use of an average rate base and simultaneously provide for interest on a weighted average basis for that year, then ComEd would not fully recover its cost of capital.

Q. **Mr. Brosch asserts that because the rate base used to set the initial rates "selectively" includes forecasted data it is analogous to a future test year, which generally utilizes an average rate base. Is this a valid comparison?**

A. No. First, I would note that ComEd does not "selectively" pick and choose in which instances projected data should be used. Rather, ComEd followed the statute which expressly prescribed that projected data should be used for plant additions and accumulated depreciation and depreciation expense. Further, the use of historical calendar year data with projections of plant additions that are expected to be in service prior to the point in time that rates reflecting those costs go into effect would not meet the requirements for a future test year. A future test year, as defined in Title 83, Illinois Administrative Code, Part 285, would include not only projected plant additions and depreciation, but also projection of all cost elements for the future test year.

Q. **Is Mr. Brosch correct in asserting that the recovery of interest on under-recoveries has the overall effect of eliminating any financial burden associated with regulatory lag for ComEd?**

A. No. Regardless of whether interest is allowed to accrue on deferred balances, the fact that recovery of actual costs is delayed for up to two years after they have been incurred is an indication of regulatory lag. Additionally, virtually all parties have recommended that interest on delayed recoveries be provided at a rate that is substantially less than the overall weighted-average cost of capital that ComEd has invested in rate base assets. Mr. Brosch recommends that interest be provided at a short-term debt cost of capital, notes that the short-term rate for 2010 is 1.43%, and notes that the short-term debt rate is generally expected to be lower than the overall weighted average cost of capital (Brosch Dir., AG/AARP Ex. 1.0, 18:373-84); ICC Staff witness Ms. Phipps has proposed an interest rate equivalent to the rate applied to customer deposits (Phipps Rebuttal, Staff Ex. 18.0, 28:464-468), which is currently 0% (AG/AARP and IIEC also identify this as an acceptable alternative); and CUB witness Mr. Smith also proposes an interest rate for under-recoveries based on the short-term debt rate (Smith Dir., CUB Ex. 1.0 Rev., 63:1461-64). ComEd cannot predict whether the Commission will accept any of these proposals; however, if interest on the deferrals is provided for at a rate that is less than the overall weighted average cost of capital allowed on rate base, ComEd will not only receive cost recovery on a lagged basis, it will not recover the full cost of capital that was employed, which exacerbates the impact of the deferral. Use of an average rate base to set rates that will go into effect more than a year after costs are incurred will further exacerbate the regulatory lag.

X. <u>Reconciliation Issues – Interest Rate on True-up Value</u>

Q. **Staff witness Ms. Phipps continues to support Staff's recommendation that an interest rate equivalent to the rate authorized by the ICC for customer deposits (currently 0%) be applied to the reconciliation calculation. Is her justification for this rate valid?**

A. I understand Ms. Phipps position to be supported by a chain of logic that goes as follows: the actual cost of capital is irrelevant because it does not reflect the required return on new assets; the unrecovered costs computed in the reconciliation are new assets; these new assets are equivalent to AAA-rated transitional funding instruments issued by ComEd in the late 1990s which require a lower rate of return on these assets than other ComEd assets; the expected return on AA-rated bonds is 0.40%, which is close to zero; it is easier to look up the customer deposit rate than bond yields so customer deposit rate of 0% should be used. Each element of this chain of logic is flawed.

Q. **Why is the presumption that the actual cost of capital is irrelevant not valid?**

A. First, it is inconsistent with the intent of the statute, which is to provide for a formula rate that recovers the actual costs of delivery service. This is not a proceeding where parties are required to project costs of capital for future periods to develop rates that will remain in effect for multiple years in the future. The purpose of this proceeding is to establish a formula rate that is updated annually to allow ComEd to recover its actual costs, no more and no less, on a timely basis. If Ms. Phipps is correct that investors perceive ComEd as having a lower cost of capital because its portfolio of assets in future years includes a regulatory asset that has lower risk, then that perceived lower risk will be reflected in the cost of new securities issued in future calendar years and will automatically be reflected in ComEd's overall cost of capital each year as the formula is updated for new actual data. In short, there is no need to speculate on future capital costs under a formula framework where costs and benefits will be updated each year. Further, unless this perceived benefit can be carved out of the overall cost of capital, which it cannot practically be, then it would be a double-count to attempt to apply the isolated benefit of the reconciliation adjustment that might be buried in ComEd's overall cost of capital to the reconciliation asset unless the overall cost of capital were correspondingly increased to remove the benefit associated with that reconciliation from the cost of capital associated with other assets.

Q. **Is Ms. Phipps correct that the reconciliation amount is analogous to transitional funding instruments because it is a loan from customers and therefore should be considered much lower risk than other costs?**

A. No. My understanding is that transitional funding instruments must be supported by numerous legal and procedural elements which the current legislation does not provide for. Moreover, unless Ms. Phipps is suggesting that ComEd attempt to separately finance the reconciliation revenues (which I do not believe is the case) and even if the market did perceive that such a relationship existed, the benefit would be reflected in the cost of new securities issued and reflected in ComEd's cost of capital via the annual updates.

Q. Does Ms. Phipps position support the use of a customer deposit rate for the reconciliation?

A. No. Once Ms. Phipps arrives at the conclusion that the rate of return on the reconciliation should be equivalent to that of AAA-rated transition bonds, she makes another series of assumptions to estimate that rate by equating AA bond yields which carry a .40% rate as being close to Treasury Bond rates which carry a .14% yield. Phipps Reb., Staff Ex. 18.0, 26:435-27:468. To make this leap Ms. Phipps brushes aside the fact that the duration of the reconciliation is longer than one year by stating that a 30-year mortgage with a fixed rate is different than a 30-year mortgage with an interest rate that resets annually, and then implies that a 30-year mortgage with a rate that resets annually will carry a rate that is equivalent to a one-year Treasury yield. *Id.* While I agree that the interest rate on the 30-year variable rate mortgage will be different than the 30-year fixed rate, I do not believe it is realistic to assume that a 30 year mortgage will carry a rate that is equivalent to one-year treasury yields simply because the rate is reset annually. The duration of the loan (30 years), will result in a rate that is higher than a one-year rate, even if the rate on the 30-year loan is reset each year. Finally, Ms. Phipps makes one final leap to conclude that the use of one-year treasury yields is close to the zero percent rate on customer deposits and that the customer deposits rate is easier to find so that should be the appropriate rate. *Id.* This chain of logic is completely speculative and based on invalid assumptions. The use of a customer deposits rate would simply not afford ComEd an opportunity to recover its actual cost of capital.

Q. **AG/AARP witness Mr. Brosch continues to advocate use of a short-term debt interest rate for the reconciliation and IIEC witness Mr. Gorman dismisses your argument that use of a short-term debt rate for interest calculations is not appropriate since all of the short-term debt is either applied to CWIP or included in the capital structure by claiming that it is unlikely that ComEd would issue additional common stock or debt in order to fund the reconciliation amounts. How do you respond?**

A. Mr. Brosch simply affirms his original position and does not address my position that a short-term debt rate should not be used unless the short-term debt is assumed to be financing rate base, which is not the case except to a very limited degree as discussed in Mr. Vogt's testimony. Mr. Gorman incorrectly asserts that I implicitly believe there should be a clear trace of the funding source for the reconciliation. Gorman Reb., IIEC Ex. 2.0, 7:156-63. That is incorrect, and in fact the opposite is true. Given the fungible nature of cash, I believe it is difficult to identify whether the funding for the revenue shortfall will come from either the long-term debt, internally-generated equity, or short-term debt, and my position that the overall weighted cost of capital should be used is consistent with that assumption. As I indicated in direct testimony, if Mr. Gorman's position that the funding of the reconciliation can be directly traced to short-term debt issuances is accepted, then that short-term debt must be removed from the capital structure that is used to finance rate base assets. Directly assigning short-term debt to the reconciliation value and at the same time including that short term debt in the capital structure assumed to be financing rate base would be a clear double counted reduction in cost recovery. Moreover Mr. Gorman's own position is internally contradictory in that he claims that the precision necessary to track short-term debt and customer deposit balances throughout the year is not available but then supports a position that assumes those sources can be assumed to be available throughout the year to support the lag until the reconciliation adjustments are implemented. Gorman Reb., IIEC Ex. 2.0, 7:164-8:195.

Q. If the Commission were to adopt Mr. Brosch and Mr. Gorman's suggestions to use a short-term debt rate or customer deposit rate to the reconciliation amounts, what other adjustments would be required?

A. If the Commission were to accept Mr. Gorman's position that short-term debt is assumed to be used to finance the reconciliation, then the amount of short-term debt included in the capital structure should be reduced by the amount of the reconciliation to avoid a double-count of those funds. Similarly, if the assumption is that customer deposits provide a source of funding for the reconciliation, which both Mr. Brosch and Mr. Gorman support, then the customer deposits applied to finance rate base should be reduced by a like amount. ComEd has a finite amount of customer deposits available during the course of any given year, and those deposits cannot be assumed to support both rate base investment and the reconciliation. Mr. Gorman's comment that the amount of customer deposits and short-term debt outstanding may vary throughout the year, and therefore reducing the amount of customer deposits in rate base, or the amount of short-term debt in capital structure, for any amount assumed to finance capital may result in a mismatch is a complete red herring. The balance of customer deposits varies only slightly throughout the course of the year. For example, in 2010 the balance of customer deposits varied from a low of $128 million to a high of $133 million, a range of only about 4%. *See* ComEd Ex. 13.3, Sched. B-13 Revised. Also, although short-term debt balances vary more throughout the year, the amount included in the capital structure is based on a 13-month average, and hence the variability that Mr. Gorman is concerned about has already been accounted for.

Q. **Mr. Gorman states that because the reconciliation value can be credits or charges, the interest rate should not matter because the cost or benefits will be symmetrical over time. Is this a valid assumption?**

A. No, in fact it is very misleading. First of all, if ComEd and its customers should be indifferent as to what interest rate is used, then it is not clear to me why Mr. Gorman believes it is so important to use a short-term debt rate. While it is true that the reconciliation value can be charges or credits, he provides no basis for his assumption that there will in fact will completely offsetting amounts of charges and credits throughout the period. There is no reason to assume that every dollar of reconciliation charge will be offset by an equal amount of credit in future years, and such a coincidental result would be extraordinarily unlikely. Moreover, costs tend to rise over time. The reconciliation will have real economic consequences, either in the form of charges or credits, and determining a proper cost of money is very important.

XI. <u>Reconciliation Issues – Earnings Collar</u>

Q. **Mr. Gorman continues to advocate that the earnings collar should be separately presented on Schedule FR A-1, rather than on Schedule FR A-1 REC, in the interest of transparency. Is the earnings collar presented in a transparent manner in ComEd's proposed formula?**

A. Yes. The earnings collar is clearly set forth on a separate line on the second page of the formula, ComEd Ex. 13.1, Sched. FR A-1 REC. While it is combined with the interest amount and the true-up value on Schedule FR A-1, it is hardly "buried" in the calculation simply because one has to turn the page to separately identify the amount. It seems to me that any party that has an interest in knowing what the earnings collar is will necessarily have some familiarity with the formula and should not be overburdened by needing to look to the second page, rather than the first, to find that amount. As I explained in rebuttal, the primary reason it is combined on the first page with the reconciliation amount is to allow for a combined interest calculation. Unbundling the components as Mr. Gorman would suggest would unduly complicate the interest calculation and should not be done in the absence of a better reason than a preference to see a number presented on page one rather than on page two.

Q. **Does this conclude your surrebuttal testimony?**

A. Yes.