STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

REPLY BRIEF ON REHEARING OF THE CITIZENS UTILITY BOARD AND THE CITY OF CHICAGO

Julie Soderna, Director of Litigation
Orijit Ghoshal, Attorney
CITIZENS UTILITY BOARD
309 W. Washington St., Ste. 800
Chicago, IL 60606
jsoderna@citizensutilityboard.org
oghoshal@citizensutilityboard.org

Stephen Patton, Corporation Counsel
Ronald D. Jolly, Senior Counsel
THE CITY OF CHICAGO
30 North LaSalle St., Ste. 900
Chicago, IL 60602
rjolly@cityofchicago.org

Table of Contents

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

REPLY BRIEF ON REHEARING OF
THE CITIZENS UTILITY BOARD AND THE CITY OF CHICAGO

Now come the Citizens Utility Board ("CUB"), and the City of Chicago ("City"), by Stephen Patton, Corporation Counsel, pursuant to Rules of Practice of the Illinois Commerce Commission ("ICC" or "the Commission") (83 Ill. Admin. Code Part 200.800) and the briefing schedule established by the Administrative Law Judges ("ALJs"), to hereby file this Reply Brief on Rehearing in the above-captioned proceeding. This Reply Brief responds to the Initial Briefs of Commonwealth Edison Company ("ComEd" or the "Company"), the Staff of the Illinois Commerce Commission ("Staff"), and Illinois Industrial Energy Consumers ("IIEC").

I INTRODUCTION

As stated in CUB-City's Initial Brief, ComEd has cobbled together novel theories of the intent and operation of Energy Infrastructure Modernization Act ("EIMA") with regard to (1) the interest to be applied to the reconciliation balance and (2) the use of year-end rather than average rate base in determining the reconciliation revenue requirement. CUB-City Init. Br. on Reh. at 2-7. In order to support its manufactured interpretation of the intent of EIMA, ComEd has constructed a cost recovery timeline that distorts the cost basis of rates inherent in the Public

Utilities Act ("PUA"). The General Assembly was clear in ensuring that the Commission retained the authority under EIMA to "determine whether the utility's actual costs under the program are prudent and reasonable," (220 ILCS 5/16-108.5(b)(5)), and to provide for the recovery of such delivery service costs consistent with Commission practice and law (220 ILCS 5/16-108.5(c)). In making its determination on Rehearing, the Commission must adhere to these fundamental principles, and to the plain language of the EIMA.

The Commission identified three issues to be addressed for rehearing: (1) pension asset; (2) use of average test year rate base for measuring the formula rate revenue requirement; and (3) the interest rate that should be applied on under- and over-collected reconciliation balances. CUB's testimony and briefs in this matter address the second and third issues but not the first.

All parties to the initial proceeding and this rehearing – with the sole exception of ComEd – agree that the Commission should affirm its decisions in the initial phase of this case that the formula rate revenue requirement should be based on average and not year-end rate base. With regard to the proper measurement of rate base, Staff noted: "The use of average rate base for purposes of calculating a reconciliation revenue requirement is consistent with other sections of the Act, Commission Rules, and prior Commission practice." Staff Init. Br. on Reh. at 37. The Commission agreed with Staff, CUB, the City, the People of the State of Illinois by Attorney General, Lisa Madigan and AARP ("AG-AARP"), and IIEC on these points in the initial phase of this proceeding. In its Final Order, the Commission correctly concluded that average rate base should be used as the basis of determining the formula rate revenue requirement and reconciliation, and that using the Weight Average Cost of Capital ("WACC") as the interest rate for reconciliation balances was inappropriate. ICC Docket No. 11-0721, Final Order at 166 (May 29, 2012) ("May 29 Order").

In its May 29 Order, the Commission determined a 3.42% interest rate on the reconciliation balance, which it described as "the weighted costs of short-term and long-term debt [and which] exclude[d] the weighted cost of common equity." May 29 Order at 166.

With respect to the interest rate applicable to reconciliation balances, on rehearing each party had different recommendations.

In the rehearing, ComEd advocated use of its WACC for both under-recovered reconciliation balances and for over-recovered reconciliation balances. ComEd Init. Br. on Reh. at 21-30. Staff accurately and succinctly summarizes the ComEd position as follows:

> The Company maintains that any interest rate less than the WACC authorized for rate base is punitive and should be rejected. (ComEd Ex. 36.0, p 2; ComEd Ex. 37.0, pp. 1-2). However, the Company's suggestion that other proposals are punitive illogically assumes the conclusion as to what the appropriate interest rate should be. Staff Init. Br. on Reh. at 44-45.

On rehearing, Staff recommends a formula to determine the applicable interest rate that is based on applying a two-year U.S. treasury yield and a Bank of America Merrill Lynch ("BAML") index of 1-3 year investment grade bonds and a 580 basis point equity premium to determine the "time adjusted" cost rate. *Id*. at 42-43. Staff's illustrative example shows a 5.80% interest cost rate, based on capital structure components of short term debt at a 0.72% cost rate; long term debt at a 6.42% cost rate and the common equity at a "time adjusted" cost rate of 5.14%. *Id* .at 43. Staff also concluded "that interest should not be earned on the income tax portion of the reconciliation balance." *Id*. at 48.

AG/AARP recommend that the Commission should approve a blended reconciliation rate that relies upon current, rather than historical interest rates for newly issued debt that appropriately recognize the short, two-year delay in reconciling actual costs. AG/AARP Init. Br. on Reh. at 17. AG/AARP witness Brosch recommended an average of Baa-rated corporate bonds of 4.85% and short-term commercial paper current annual yields of 0.21%, which average to 2.53%. *Id* .at 18. AG/AARP also advocate that no interest should be applied to the portion of the reconciliation balance that represents deferred taxes. *Id*. at 22-27.

As in the first phase of this proceeding, CUB witness Ralph Smith continues to recommend that the Commission adopt an asymmetrical interest rate proposal for over- and under-recoveries. Thus, while CUB-City agree with Staff and other intervenors that the WACC should not be applied to under-recoveries, the WACC is the appropriate interest rate to apply to over-recoveries because ratepayers will have financed the over-recovery at the WACC rate, and applying the WACC to over-recoveries protects ratepayers from utility-created over-recoveries that result from utility over-projections of plant additions. As CUB witness Smith pointed out, the Florida Public Service Commission has employed similar provisions to properly balance the interests of ratepayers and utility shareholders where over- and under-collections result from utility surcharge provisions. The Florida practice of deducting over-collected recovery mechanisms from utility rate base (to effectively provide ratepayers with a return at the utility's WACC) while excluding under-recovered balances from utility rate base (which effectively allows the utility to collect only the carrying charge rate provided for in the surcharge, typically a short-term debt rate) provides a regulatory illustration of how this policy is used to fairly balance the interests of the utility and its customers, and to encourage the utility to make accurate projections so as not to produce large over-recoveries. CUB Ex. 5.0 at 15-16 and 18-21.

With regard to the appropriate interest rate to apply to under-recoveries, CUB-City believe the underpinnings of the Commission's hybrid-developed interest rate to be applied to reconciliation balance charges (that is, under-recoveries) are sound. However, on rehearing, AG witness Brosch developed a more appropriate interest rate to be applied to under-recoveries. Mr.

Brosch proposed a blend of short- and long-term debt based on current market rates for corporate bonds and short-term non-financial commercial paper to produce an interest rate based upon current marginal costs of short/long term debt of 2.53%. AG/AARP Ex. 5.0 at 15:367-373. CUB-City therefore recommend that the Commission adopt the AG's recommended 2.53% for under-collected reconciliation balances, and apply the WACC to over-collected balances

II. ARGUMENT

A. USE OF AVERAGE CALENDAR YEAR RATE BASE FOR ANNUAL RECONCILIATIONS

The Commissioners made clear, in granting rehearing on this issue, that the goal of examining this issue was to "get it right"; the Commissioners did not grant rehearing to deliver an inflated reconciliation rate base that would provide the Company with greater than full cost-recovery. *See* Public Utility Special Open Meeting, Tr. 9-10 (June 22, 2012). ComEd has not introduced any new evidence or argument on rehearing that questions the ICC's correct construction of Sections 16-108.5(c)(6) and 16-108.5(d)(1) of the Act. Under the average-year rate base calculation for reconciliation purposes, ComEd fully recovers its actual costs of service. IIEC Init. Br. on Reh. at 23.

Despite this, the Company continues to argue that the phrase "for the calendar year" in Section 16-108.5(c) of the Act means the total amount of plant additions for the entire calendar year. ComEd Init. Br. on Reh. at 31-32. As CUB witness Ralph Smith testified, the plain meaning of a "calendar year" is a 12-month period, not one day. CUB-City Init. Br. on Reh. at 9. If the General Assembly intended "calendar year" to mean "last day of the calendar year," it could have so specified. Staff witness Bridal concurred that "calendar year" carries its plan meaning, and requires the reconciliation of the rate base which represents the entire period from

January 1 through December 31 of the applicable year, not merely the balance at the end. Staff Ex. 26.0 at 3-4.

Staff, AG/AARP, the IIEC, and CUB-City have all illustrated how use of average calendar year rate base for annual reconciliations is appropriate and should be affirmed on rehearing. CUB/City agree that the use of average-year rate base for reconciliation purposes allows the Company to recover, with interest, its prudent and reasonable actual costs of service. Yet, ComEd claims that only the year-end figure fully reflects the plant investments that went into service in that calendar year. ComEd Init. Br. on Reh. at 32. As multiple intervenors have pointed out, using the year-end figure potentially provides a year's worth of return on a plant addition only in service for $1/365^{th}$ of the year. CUB Ex. 5.0 at 2-4; *see also* AG/AARP Ex. 6.0 at 5. ComEd's proposal does not "fully reflect" the rate base upon reconciliation, rather it would improperly recover from ratepayers more than the Company is due under any cost-based recovery scheme. *See* IIEC Init. Br. on Reh. at 18. Indeed, use of an average reconciliation rate base "would primarily delay the timing of cash flows, with a less significant impact on earnings." CUB-City Init. Br. on Reh. at 14 (quoting Exelon Corp. Quarterly Report Pursuant to Section 13 or 15(d) (Form 10-Q), 43-44 (May 10, 2012)).

Regarding the statutory source of the data used to calculate the rate base for reconciliation purposes, the Company argues that Section 16-108.5(d)(1) of the Act's specifications for "final historical data" and "actual costs" from the FERC Form 1 require use of the end-of-year investment totals. ComEd Init. Br. on Reh. at 32. However, ComEd's "final historical data" argument does not support the use of only the year-end FERC Form 1 data point, rather, the final FERC Form 1 contains both beginning and ending rate base amounts for the applicable year. IIEC Init. Br. on Reh. at 14. Because the FERC Form 1 contains both beginning and ending rate base amounts, it is disingenuous for ComEd to imply that the EIMA requires that the beginning rate base amount be excluded from the reconciliation rate base calculation. Staff Init. Br. on Reh. at 35. The Company's relevant "actual cost information for the applicable calendar year" is the Company's plant in service for the entirety of a 12-month period, not just the plant in service for the single date at the end of the calendar year. *Id*. at 34.

ComEd points to other provisions of the Act where the General Assembly explicitly directed the ICC to use an average instead of year-end figure as proof that the General Assembly chose to direct use of final historical data instead of average data to determine rate base. ComEd Init. Br. on Reh. at 32-33 (citing 220 ILCS 5/16-108.5(b) (average capital spend over 3 years); 220 ILCS 5/16-108.5(c)(3)(A) (30 year U.S. Treasury bonds); 220 ILCS 5/16-111(e) (earned rate of return on common equity when subject to rate cap). ComEd's point is in error for several reasons. First, even if it is accepted that the General Assembly chose to direct use of final historical data, as demonstrated above, that final data includes both beginning and ending rate base amounts and thus does not resolve the debate over year-end or average rate base.

Second, the other provisions cited by ComEd are not similar to the reconciliation rate base provision at issue. The first provision, averaging capital spend of three calendar years, clearly differs in that it averages spending over three years' time instead of one year. Further, this provision is from a different subsection of the EIMA, and thus is not as persuasive a sign of the General Assembly's intent on this particular provision as other provisions in the same subsection – as illustrated below. The second provision, averaging monthly yields of Treasury bonds, while from the same subsection as the provision at issue, does not raise the concerns of mismatch or manipulation that the Company's reported rate base amounts poses for ratepayers. *See* CUB-City Init. Br. on Reh. at 11. The third provision, return on common equity under a rate cap, comes from a part of the Act governing entirely different concerns regarding the utility's recovery of bundled rates. This provision operated differently than any ratepayer protections in place under the formula rate structure. *Compare* 220 ILCS 5/16-111(e) *with* 220 ILCS 5/16-108.5(c).

Third, if ComEd's argument that omission of a particular term from one provision in the EIMA indicates the General Assembly's intent to not apply that concept is accepted, then ComEd's proposal to use year-end rate base must be rejected. Under the subsection of the Act at issue, ComEd's investment return on pension assets is measured partly with reference to the Company's long-term debt costs of capital "as of the end of the applicable calendar year." 220 ILCS 5/16-108.5(c)(4)(D). Clearly then, the General Assembly was aware of how to apply the concept of year-end measurements of data to amounts the Company is allowed to recover from ratepayers. According to the Company's logic, the legislature's failure to use the term "year-end" or "end-of-year" when defining the rate base amounts to be reconciled indicates that the Act provides "no such direction" to use those year-end amounts.

Finally, ComEd claims that use of the average rate base denies the Company full recovery of its prudent and reasonable costs of service, including its costs of capital. ComEd Init. Br. on Reh. at 34. ComEd adds that the average rate base method affords the Company recovery of only half of its total rate year investments, since the Company has already invested the full final amount from its FERC Form 1 before any reconciliation adjustment is applied. *Id*. ComEd fails to explain how the Act, and the EIMA's earning collar mechanism in particular, allows ComEd to recover anything less than its actual reasonable and prudent cost of service for every rate year. IIEC Ex. 3.0RH at 5. As long as the interest rate applied to the reconciliation balance is reasonable, ComEd will be made whole for its actual costs through the reconciliation process, even using an average rate base approach. CUB-City Init. Br. on Reh. at 14.

The Commission should affirm its May 29 Order and issue an Order on Rehearing which continues the use of average year rate base as opposed to end-of-year rate base for the purpose of setting the reconciliation revenue requirement. This will allow the Company full recovery of its prudent and reasonable costs and does not suffer from any unlawful regulatory lag.

B. CARRYING COST RATE FOR ANNUAL RECONCILIATIONS

ComEd claims that the only interest rate that will make it "whole" is WACC. ComEd Init. Br. on Reh. at 24. However, as Staff points out, "the Company's suggestion that other proposals are punitive illogically assumes the conclusion as to what the appropriate interest rate should be." Staff Init. Br. on Reh. at 44-45. For all the reasons in CUB-City's Initial and Reply Briefs in the initial phase of this proceeding, the Commission's Final Order in the initial phase of this proceeding, and the Initial Briefs on Rehearing of CUB-City, Staff, IIEC and the AG-AARP, applying the WACC on under-collected reconciliation balances is inappropriate. May 29 Order at 166; CUB-City Init. Br. on Reh. at 15-31; Staff Init. Br. on Reh. at 39-54; IIEC Init. Br. on Reh. at 3-12; AG-AARP Init. Br. on Reh. at 9-27. CUB recommends that a debt-based interest rate should be applied to under-collected reconciliation balances. CUB supports applying the WACC to over-collected reconciliation balances as an appropriate ratepayer protection from utility over-projections. CUB Ex. 5.0 at 21-23.

CUB-City, Staff, IIEC, and AG-AARP support the Commission's decision to exclude common equity from the calculation of the interest rate for under-collected reconciliation balances, and support an interest rate for under-collections that is based on a blend of short-term and longer-term debt rates that correspond with the period during which ComEd would need to finance an undercollection. *See, e.g.*, CUB Ex. 5.0 at 21-22; AG/AARP Init. Br. on Reh. at 21-30; IIEC Init. Br. on Reh. at 2 and 7-9.

ComEd believes that because it will always be spending more than it recovers in rates, and cannot "separately finance" the reconciliation balance, it should therefore receive a full equity return (in the form of its WACC) on the reconciliation balance. ComEd Init. Br. on Reh. at 3. ComEd's claims are incorrect for several reasons.

1. ComEd Has Adequate Sources of Economical Short Term Financing That Could Be Used to Temporarily Finance an Under-Collected Reconciliation Balance

As an initial matter, it is important to recognize that WACC is a long term capitalization rate, (IIEC Ex. 3.0RH at 15:339-340), and thus inappropriate to apply to the 12-24 month delay in recovery of the reconciliation regulatory asset. The one to two-year "carrying" period for reconciliation balances that are under-recovered suggests an interest rate based on a mix of short-term and intermediate term debt, instead of a long term capitalization rate as proposed by the Company. CUB Ex. 5.0 at 12.

Moreover, ComEd is wrong in claiming that it cannot temporarily finance the reconciliation balance using debt sources: "the suggestion that ComEd should recover a lower rate is premised on the assumption that ComEd could carve out the reconciliation balance and finance it separately from the rest of its costs. However, the uncontested evidence is that ComEd cannot separately finance the reconciliation balance…" ComEd Init. Br. on Reh. at 3. This is not true. If ComEd has an under-collected balance, it would be a new, temporary, incremental cost item and therefore *could* be financed using incremental sources of short-term debt. ComEd could issue one-year or two-year notes to temporarily finance portion of any under-collection, with interest rates lower than long term debt. CUB Ex. 5.0 at 14-15. As discussed in CUB-City's Initial Brief, ComEd has ample access to low-cost debt sources to finance this type of short-term incremental asset balance, including the low cost sources of one- to two-year debt that were listed in response to CUB 6.01 as CUB Cross Exhibit 1. The undercollected reconciliation balance would be temporary, and thus could be addressed with incremental and temporary short-term debt that is not currently reflected in ComEd's capital structure, and would not be reflected in ComEd's capital structure, since it would be dedicated to financing incremental under-collected reconciliation balances, similar to how some of a utility's short-term debt is dedicated to financing construction work in progress ("CWIP"). That portion of short-term debt is therefore excluded from the utility's capital structure for revenue requirement purposes. CUB Cross Exhibit 1 used during the cross examination of ComEd's witness Mr. Trpik, contains ComEd's response to data request CUB 6.01 and shows that ComEd has abundant available sources of low-cost short-term financing that could be used to finance an incremental balance that required temporary financing on a one- to two-year basis. CUB Cross Ex. 1.

CUB Cross Exhibit 1 also shows that ComEd believes that each such ComEd financing source has an interest rate/carrying cost that is below or comparable with the 1.5% advertised rate for the Duke Energy Premier Notes®. Duke Energy has advertised Duke Energy Premier Notes® in the current issue of the Journal of Accountancy at an interest rate of 1.5%. Those notes involve Duke's obtaining funds directly from investors. Similar to ComEd, Duke also uses commercial paper and has lines of credit available as other funding sources it could use for short term borrowings. CUB Cross Exhibit 1 also shows that ComEd does not classify the Duke Energy Premier Notes® as low-cost relative to ComEd's own current short term borrowing plan or in comparison with ComEd's access to lower cost sources of short-term financing, which are detailed in CUB Cross Exhibit 1.

Attachment 1 to ComEd's response to CUB 6.01, in fact, shows that ComEd has other sources of short-term financing available that could potentially be used to temporarily finance formula rate plan under-collections that might arise in a given year, such as 2011. CUB Cross Ex. ComEd's Attachment 1 to CUB 6.01 shows that ComEd has three such potential funding sources, each of which has an interest rate below 1.5%: (1) commercial paper; (2) line of credit borrowings; and (3) one to two-year bank loans. Any of these short-term borrowing sources could be used by ComEd to finance formula rate plan undercollections, and each has an interest rate that is lower than the 1.5% advertised rate for the Duke Energy Premier Notes. Consequently, ComEd could finance the entire amount of a formula rate plan undercollected reconciliation balance with the short-term borrowing options listed in Attachment 1 to the response to CUB 6.01, and the resultant effective financing cost to ComEd would be comparable to or below the 1.50% rate listed for the Duke Energy Premier Notes®. As IIEC stated, "a short term funding source that provides the utility with borrowing flexibility would be the most prudent and reasonable source of funds for reconciliation adjustment balances." IIEC Init. Br. on Reh. at 7.

The sources of potential financing ComEd included in CUB Cross Exhibit 1 are the most economical form of financing available. The charges to ratepayers should be based on available sources that are the most economical. If, for some reason, ComEd management chooses not to finance the temporary under-collection in the most economical manner, then shareholders, not ratepayers, should be responsible for any additional cost that is unnecessarily incurred from such a decision. ComEd has failed to demonstrate that under-collected balances could not be financed temporarily using short term financing, such as short-term debt or line of credit based draws, as demonstrated above. CUB Ex. 5.0 at 14:331-344. The incremental short term debt used by

ComEd to temporarily finance a formula rate plan reconciliation balance under-collection would be specific to that purpose and would not be included in ComEd's capital structure for other ratemaking purposes.

In its Initial Brief, ComEd claims that "it is uncertain whether ComEd would even be able to access sufficient short-term debt to finance the entire reconciliation balance in that manner [by using solely debt to finance the reconciliation balance]." ComEd Init. Br. on Reh. at 29. However, Mr. Trpik testified that ComEd could potentially raise $400 million of commercial paper borrowings at the current rate and that ComEd has $1 billion as a line of credit. Tr. at 63-64 (Aug. 3, 2012). Additionally, ComEd has access to bank loans at attractive interest rates . CUB Cross Ex. 1. Thus, the record demonstrates that ComEd has ample access to short-term debt.

2. The WACC Should Apply Only to Over-Collected Reconciliation Balances

The notion that ComEd should be rewarded with an equity return on any under-recovery is based on the false premise that ComEd is entitled to much more than simply the cost of money on the difference between the projected and actual costs from one 12-month period. ComEd overstates the reconciliation balance both by expanding the reconciliation period and by asserting its WACC should be applied to it. The reconciliation balance, however, is not a rate base item. As Staff explained:

> The Company seeks to have the reconciliation adjustment treated as a rate base item by applying the same WACC applied to its rate base. However, the reconciliation adjustment asset is unambiguously not a rate base item. Significantly, the term of the reconciliation adjustment asset differs drastically from rate base. While the weighted average life of rate base exceeds 30 years, the reconciliation adjustments have a life of only two years, which the Company acknowledges. All else equal, investments in assets with different lives have different required rates of return. (Staff Ex. 25.0, p. 3) For example, Company witness Hadaway

> acknowledged that, all else equal, 2-year bonds generally have lower yields than 30-year bonds. (*Tr.*, August 3, 2012, p. 90) Thus, it is clear that the reconciliation adjustment does not warrant a return equal to the WACC applied to rate base. Staff Init. Br. on Reh. at 45.

ComEd claims that "during a time when ComEd is making large, substantial new capital investments over the course of each year – as ComEd is called to do under IEMA – ComEd's actual revenue requirement during the rate year will likely be significantly greater than the revenue requirement used to set rates for that year." ComEd Init. Br. on Reh. at 22. In fact, if ComEd's projections for any given revenue requirement year were exactly correct, there would be no reconciliation balance at all. That is, if ComEd accurately projects its costs for 2014, those costs will be totally recovered by the end of year 2015 – only 12-24 months after they were incurred (because the revenue requirement in effect in 2015 includes actual costs from 2013 and projected costs for 2014). In this scenario, there would be no reconciliation balance to recover. An under-collected positive reconciliation balance (or charge) would exist after 2015 only if ComEd under-projects its 2014 costs. However, the evidence in the rehearing phase suggests that ComEd has over-projected its plant additions and is now in the process of curtailing spending so ComEd management can manage its spending to meet Company earnings targets. As CUB witness Smith pointed out:

> ComEd Ex. 31.1 indicates at page 5 that ComEd will not proceed with its previously filed investment plan, particularly for discretionary investments such as AMI" and that "[i]n general, ComEd will need to pull back on planned investments because of the reduction of expected revenue." ComEd Ex. 31.1 goes on about curtailing or abandoning its previously filed plant additions plan. This pullback and curtailment by ComEd of previously projected plant additions is one illustration of how ComEd can and apparently will revise its actual capital expenditures to conform with Company earnings goals. Thus, ComEd management can have substantial influence over whether over- or under-collections are produced by similar decisions to curtail planned plant additions. The Commission should acknowledge that both the

> projected level and the actual level of expenditures are heavily under the direct influence of ComEd management, and that actual expenditures can apparently be curtailed by ComEd management after the Commission determines formula rates based on, and relying upon, ComEd's projected plant additions. This factor has now become apparent to such clarity that, if it wasn't sufficiently apparent during the earlier proceedings, it should be now. The control and discretion exerted by ComEd management on not only budgeted capital expenditures but also on the level of actual expenditures subsequently made, and thus the ability to influence and manage whether there are under- or over-collections, in itself, should be sufficient to justify and require the imposition of different carrying charges on over- and under-collections. CUB Ex. 5.0 at 22-23. CUB-City Init. Br. on Reh. at 5

In order to protect ratepayers from ComEd over-projections of plant additions and from subsequent decisions by Company management to "manage" or curtail spending in view of other Company objectives, such as meeting corporate earnings targets, the Commission should adopt an interest rate for over-collections at the WACC that will protect Illinois ratepayers. Using the WACC only for over-collected reconciliation balances will provide protection to Illinois jurisdictional ratepayers similar to that which has been recognized by the Florida Commission to be necessary based on the same rationale for applying a WACC to over-recoveries, which as stated by the Florida Commission "is to provide the Company with an incentive to make its projections for the cost recovery clause as accurate as possible and avoid large over-recoveries."[1]

3. A Hybrid Debt Rate, such as AG Witness Brosch's Hybrid Cost Rate of 2.53% Is An Appropriate Interest Rate for Reconciliation Balance Over-Collections

AG/AARP witness Brosch recommended a blended interest rate that could reasonably be applied to ComEd's under-collected reconciliation balances, based upon current marginal cost rates for short- and longer-term debt and the Commission's debt blending methodology. He used

---

[1] Florida Public Service Commission, Order No. 12663, issued November 7, 1983, in Docket No. 830012-EU, *In re: Petition of Tampa Electric Company for an increase in rates and charges and approval of a fair and reasonable rate of return*, pp. 14-15; and Order No. PSC-93-0165-FOF-EI, issued March 29, 1993, in Docket No. 920324-EI, *In re: Application for a rate increase by Tampa Electric Company*, p. 38.

information that is readily available from Federal Reserve System publications. AG/AARP Init. Br. on Reh. at 18. Using illustrative information for the week of July 23, 2012, AG/AARP witness Brosch derived an interest rate of 2.53% based on averaging a Baa-rated corporate bond yield of 4.85% and a commercial paper annual current yield of 0.21%. *Id*. AG/AARP also points out that "over 24 months, the utility could elect to use and roll-over short term debt financing as it matures or could employ long term debt after a period of short term financing." *Id* at 19.

ComEd has criticized the equal weighting of published market yields on the basis that the interest rates reported in the Federal Reserve System H-15 series are corporate averages rather than rates for utility debt. *See, e.g*., ComEd Ex. 37.0 at 8. However, ComEd witness Hadaway admits that the differences between reported corporate and utility interest rates are generally small. *Id* .at 8-9. Additionally, ComEd's available short term borrowing rates for one- to two-year debt financing are shown on CUB Cross Exhibit 1 and are generally lower than the 1.5% advertised rate for Duke Energy Premier Notes®. Thus, while the record shows that an interest rate applicable to a ComEd under-recovered reconciliation balance lower than the 2.53% hybrid rate recommended by AG/AARP witness Brosch could be justified, the 2.53% interest rate reflects a refinement from the 3.42% hybrid interest rate used in the Commission's May 29 Order, and better matches the applicable interest rate to the one- to two-year term that would be involved in financing an under-collected reconciliation balance. As such, CUB supports the use of the 2.53% hybrid interest rate, and the methodology for developing such rate from Federal Reserve published information, as reasonable for application to under-collected reconciliation balances.

4. Net of Tax Issue: The Interest Rate Should Apply on a Net of Tax Basis

Staff, in its brief, and AG/AARP witnesses Brosch and Effron and CUB witness Smith all agree that income tax should be deducted from the reconciliation balance. Staff states that: "Staff has concluded that interest should not be earned on the income tax portion of the reconciliation balance." Staff Init. Br. on Reh. at 48. Staff states further that:

> Staff agrees with Mr. Brosch, Mr. Effron, and Mr. Smith that the interest rate should be calculated on a net of tax basis. Further, Staff agrees that the formula for effectively excluding the income tax balance from the calculation of interest on the reconciliation balance is as follows:
>
> Annual Interest Rate x (1 – Composite Income Tax Rate) = Annual Interest Rate Net of Income Taxes. *Id*. at 51.

Staff succinctly summarizes the "net of tax" issue as follows:

> In summary, the question concerning whether the interest rate should be calculated on a net of income tax basis is straightforward: Will ComEd pay the income taxes in the reconciliation balance in advance of recovering that cost from ratepayers? The answer is unambiguously "no." Therefore, [the] interest rate should be calculated on a net of tax basis so that ComEd does not earn interest on the income tax portion of the reconciliation balance. *Id*. at 52-53.

CUB recommends that the Commission order on rehearing that the interest rate should be calculated on a net of tax basis as recommended by AG/AARP, CUB and Staff, and that the formula for effectively excluding the income tax balance from the calculation of interest on the reconciliation balance is as follows:

> Annual Interest Rate x (1 – Composite Income Tax Rate) = Annual Interest Rate Net of Income Taxes.

III. CONCLUSION

The Commission should adopt the recommendations discussed herein, and in CUB-City's Initial Brief on Rehearing. The Commission should affirm its finding that average rate base should be used and adopt the "hybrid" or "blended" interest rate of 2.53% proposed by AG/AARP witness Brosch to apply to reconciliation balances.

Dated: August 21, 2012

CITIZENS UTILITY BOARD

Julie L. Soderna, Director of Litigation
Orijit Ghoshal, Attorney
CITIZENS UTILITY BOARD
309 W. Washington, Ste. 800
Chicago, IL 60606
(312) 263-4282
(312) 263-4329 fax
jsoderna@citizensutilityboard.org
oghoshal@citizensutilityboard.org

STEPHEN PATTON
CORPORATION COUNSEL

Ronald D. Jolly
Senior Counsel
30 North LaSalle Street
Suite 900
Chicago, Illinois 60602
ron.jolly@cityofchicago.org