

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION

On Its own Motion

v.

COMMONWEALTH EDISON COMPANY,

Investigation of tariffs approved in

Docket No. 13-0386

:
:
:
:
:
:
:
:
:
:

No. 13-0553

INITIAL BRIEF OF COMMONWEALTH EDISON COMPANY

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	PA 98-0015 COMPLIANCE	3
A.	Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Calculate Interest on ComEd’s Reconciliation Balance as Authorized by the Public Utilities Act?	3
B.	Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Calculate the Section 16-108.5(c)(5) Return on Equity (“ROE”) Collar as Authorized by the Public Utilities Act?	12
C.	Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Reflect the Appropriate Tax Treatment in Calculating Interest on the Reconciliation Balance in the Formula Rate Tariff as Authorized by the Public Utilities Act?	16
III.	IMPLEMENTATION OF RATE FORMULA CHANGES, IF ANY	21
IV.	CONCLUSION	22

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION	>:	
On Its own Motion	:	No. 13-0553
v.	:	
COMMONWEALTH EDISON COMPANY,	:	
Investigation of tariffs approved in	:	
Docket No. 13-0386	:	

INITIAL BRIEF OF COMMONWEALTH EDISON COMPANY

Commonwealth Edison Company (“ComEd”) in accordance with the Rules of Practice of the Illinois Commerce Commission (the “Commission” or “ICC”) and the scheduling Order of the Administrative Law Judges, submits this Initial Brief.

I. INTRODUCTION

This investigation, commenced by the Commission on its own motion, asks whether ComEd’s filed rate formula complies with Public Act (“PA”) 98-0015.¹ *Illinois Commerce Comm’n v. Commonwealth Edison Co.*, ICC Docket No. 13-0553, (Order Oct. 2, 2013) at 3. That question was previously answered by the Commission in its June 5, 2013 Order in *Commonwealth Edison Co.*, ICC Docket No. 13-0386 (June 5, 2013). That decision correctly found that ComEd’s rate formula satisfied PA 98-0015 and specifically approved the resulting revenue requirements.

The Commission decided Docket No. 13-0386 in accordance with the procedure mandated by PA 98-0015; that decision was not made in the dark. ComEd provided advance copies of its filing to the Commission’s Staff (“Staff”) and engaged in discussions with Staff

¹ PA 98-0015, which became effective on May 22, 2013, clarified certain structural components of the rate formula used to calculate revenue requirements under the Energy Infrastructure Modernization Act (“EIMA”) and certain inputs used in those calculations. Brinkman Dir., ComEd Ex. 1.0 CORR., 5:96-8.

regarding aspects of the formula, including the specifically the tax gross-up under investigation. ComEd also shared its filing with interested parties including all of the intervenors here. No party – including the AG, CUB, IIEC, or the City – objected to ComEd’s formula on any grounds, let alone those currently being investigated.

Rather, after its own review, Staff issued a formal report of its findings to the Commission (ICC Docket No. 13-0386, Financial Analysis Division Staff Report (May 30, 2013); Brinkman Dir., ComEd Ex. 1.0 CORR., 5:100 – 6:111). Staff concluded that “the revenue requirement calculations reflected in the filing are consistent with the provisions of Public Act 98-15.” Financial Analysis Division Staff Report at 4. The Commission concurred. Thereafter, no party sought rehearing of that Order; no party appealed. No party sought a stay.

ComEd’s approved rate formula has been in effect without change since June 6, 2013. Brinkman Dir., ComEd Ex. 1.0 CORR., 6:119-22. No facts relevant to the Commission’s decision to approve that rate have changed since June 5. Nor has the law changed in any way. Rather, the parties attacking the June 5 Order and ComEd’s formula simply seek to reverse the outcome. While an investigation of this type is the *procedurally* proper vehicle to consider revising a rate formula, the parties attacking the Commission’s June 5 Order can point to no change in the relevant facts or law to justify overturning its prior decision. “In the absence of any change in circumstance,” a Commission order reversing a recent decision has been held arbitrary and capricious. *Commonwealth Edison Co. v. Illinois Commerce Comm’n*, 180 Ill. App. 3d 899, 536 N.E.2d 724, 729 (1st Dist. 1989) (holding “the Commission’s decision to supersede rates it had determined to be in the public interest less than two months earlier was arbitrary and capricious”). *See Illini Coach Co. v. Ill. Commerce Comm’n*, 408 Ill. 104, 111

(1979) (rejecting effort to reverse prior Commission decision where, as here, nothing was alleged that could not have been “properly presented on application for rehearing.”).

II. PA 98-0015 COMPLIANCE

The Initiating Order limits this investigation to three issues – whether the approved rate formula correctly: (1) calculates interest on ComEd’s reconciliation balance; (2) calculates the Section 16-108.5(c)(5) return on equity (“ROE”) collar; and (3) reflects the appropriate tax treatment in calculating interest on the reconciliation balance, a question related to potential deferred taxes. Brinkman Dir., ComEd Ex. 1.0 CORR., 7:123-30; *see also Illinois Commerce Comm’n*, Docket No. 13-0553 (Order, Oct. 2, 2013), at 2.² In each case, ComEd’s rate formula is correct. Brinkman Dir., ComEd Ex. 1.0 CORR., 7:132 – 8:148.

A. Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Calculate Interest on ComEd’s Reconciliation Balance as Authorized by the Public Utilities Act?

ComEd’s current delivery services rate formula and rates, effective pursuant to the Commission’s Order of June 5, 2013, comply with the provisions of the Public Utilities Act (“PUA”) and correctly calculate the interest on ComEd’s reconciliation balance. EIMA and PA 98-0015 allow ComEd to recover its actual prudent and reasonable costs, including the cost of financing any under-recovery. Brinkman Dir., ComEd Ex. 1.0 CORR., 13:250-51; Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3. The formula recognizes that there is an associated income tax cost related to that interest that, as with all other costs, must also be recovered. This is accomplished correctly through what is commonly referred to as the weighted average cost of capital (“WACC”) gross up. There is

² These issues were incorrectly raised in ComEd’s 2013 Formula Rate Update (“FRU”) proceeding in Docket No. 13-0318. As ComEd argued in its testimony and briefs in that docket, these distinct issues are properly addressed in the current proceeding.

nothing new or novel about WACC gross-ups. WACC ; they have been used, without objection, to collect the tax costs related to the equity component of WACC for decades – including in cases brought under EIMA³ even though EIMA does not expressly state that a tax gross-up is required.

The reconciliation adjustment is a regulatory asset or liability that reflects the difference between the revenue requirement used to establish the initial rates for a given rate year (in the current FRU proceeding, 2012) and the revenue requirement that recovers the actual costs that we now know were incurred in that calendar year. Brinkman Dir., ComEd Ex. 1.0 CORR., 12:243-46. PA 98-0015 recognizes that there is a time value of money and that, when there is an under-recovery, ComEd must finance that under-recovery – the difference between its actual costs and the amounts reflected in delivery service charges for a given rate year – until it is included in charges two years later. *Id.* at 12:246-49.

Prior to PA 98-0015, that interest rate was set based on a two-year, and then on a short-term, debt cost. *Commonwealth Edison Co.*, Docket No. 11-0721 (Rehearing Order Oct. 3, 2012) at 36; *Commonwealth Edison Co.*, Docket No. 12-0321 (Order Dec. 19, 2012) at 86. The premise was that ComEd could finance the shortfall with only debt and, most recently, with only short-term debt rather than with all the components of ComEd’s capital structure, as ComEd financed its other assets. *Commonwealth Edison Co.*, Docket No. 11-0721 (Rehearing Order Oct. 3, 2012) at 33-36; Brinkman Dir., ComEd Ex. 1.0 CORR., 18:385-67. PA 98-0015 rejected that premise, legislatively voided the Commission decisions based on that premise, and directed

³ After being directed to respond to Data Request ComEd→AG 2.03, the AG persisted in objecting and still rebelled against the simple question asked. Nonetheless, the AG acknowledged it was aware of no dispute over whether “the equity component of the overall rate of return ... yields an income stream that is subject to income taxation.” See AG Response to Data Request ComEd→AG 2.03 attached as Attachment A to this Brief. The AG simply asks to ignore that tax, by defining the cost recovered by the utility as being interest, when in fact the utility collects interest income in an amount “calculated” to recover both its equity and debt costs.

that the time value of money was to be based on ComEd's whole capital structure. 220 ILCS 5/16-108.5(d)(1) and (k). PA 98-0015 directed that the interest rate (*i.e.*, the time value of money) applicable to the delay in receiving (or refunding) the reconciliation adjustment is "to be calculated at a rate equal to" ComEd's WACC. 220 ILCS 5/16-105.8(d)(1)⁴; *see also* 220 ILCS 5/16-108.5(k)(2) and (3). The law legislatively confirms that ComEd finances these under-collections with its full capital structure (Brinkman Sur., ComEd Ex. 4.0, 6:117-23), and any continued suggestions that ComEd either can or actually does do something else is not only contrary to the evidence, but inviting an unlawful decision.

Thus, to recover any financing costs, it is necessary to recognize the added tax costs associated with the equity component of the capital financing that portion of rate base. Brinkman Dir., ComEd Ex. 1.0 CORR., 15:294-96. This includes taxes that will need to be paid as a result of the cash collected for the reconciliation – any revenue that ComEd receives for the interest on the reconciliation balance is subject to income taxes, and must be recovered in addition to the actual carrying costs related to the reconciliation. *Id.* at 14:281-83. If the interest rate is not grossed up for this added tax cost, the additional revenues will not be grossed up for the impact of income taxes and ComEd will be unable to recover or refund its full carrying costs related to reconciliation. *Id.* at 19:391-97. The straightforward principle that WACC must be adjusted for this tax effect has been recognized for decades in the context of WACC applied to rate base, and its critical importance is no different in this context. *Id.* at 16:331 – 17:340; Fruehe Dir., ComEd Ex. 2.0, 4:69-79.

⁴ The relevant portion of Section 16-108.5(d)(1) provides *in toto* as follows: "Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year."

The legislature in Public Act 98-0015 made clear that setting reconciliation interest at a rate other than a utility's weighted average cost of capital was inconsistent with the original provisions and intent of EIMA, and stressed that in specifying that interest was to be calculated at a rate equal to WACC it was giving binding effect to the provisions of House Resolution 1157, adopted by the House of Representatives of the 97th General Assembly, and Senate Resolution 821, adopted by the Senate of the 97th General Assembly:

(k) The changes made in subsections (c) and (d) of this Section by this amendatory Act of the 98th General Assembly are intended to be a restatement and clarification of existing law, and intended to give binding effect to the provisions of House Resolution 1157 adopted by the House of Representatives of the 97th General Assembly and Senate Resolution 821 adopted by the Senate of the 97th General Assembly that are reflected in paragraph (3) of this subsection.

220 ILCS 5/16-108.5(k).⁵ The House and Senate Resolutions make absolutely clear that the intent of requiring the reconciliation to be “with interest” was to ensure that the utility and customers are made whole when a reconciliation adjustment is necessary:

WHEREAS, The Energy Infrastructure Modernization Act further provides in subsections (c) and (d) of Section 16-108.5 that those amounts to be credited or charged to customers following the annual reconciliation process under the performance-based formula rate shall be "with interest" *so the utility will be made whole for unrecovered amounts that were prudently and reasonably incurred and customers will be made whole for amounts they overpaid, if any; and*

WHEREAS, Such interest is intended to be set at the utility's weighted average cost of capital, determined in accordance with the statute, which represents the reasonable cost and means of financing a utility's investments and operating costs, *so that the utility and customers are made whole when charges or credits are necessary to reconcile to actual prudent and reasonable investments and costs.*

⁵ Paragraph (3) of subsection (k) includes a specific reference to “interest calculated at a rate equal to the utility's weighted average cost of capital.” *Id.*

Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3. The proposals to exclude the tax effects of receiving or paying interest on the reconciliation balance in calculating interest equal to a utility's WACC would prevent the utility and customers from being made whole when charges or credits are necessary to reconcile to actual prudent and reasonable investments and costs; as such, these proposals are contrary to EIMA and must be rejected.

Because ComEd's full capital structure includes both debt and equity components, ComEd must calculate a WACC-based interest to recover its costs. *See* Brinkman Sur., ComEd Ex. 4.0, 6:119-23. One of these financing costs is taxes. As Staff acknowledges in this case, "the Commission routinely grosses up for income taxes the revenues it authorizes utilities in a rate case to recover from ratepayers ... [and this] allow[s] the utilities to earn the authorized return even after they have paid income taxes owed." Bridal Reb., Staff Ex. 2.0, 3:48-51. The genesis of these tax costs is plain: the portion of the interest that pay the equity cost component of the WACC will be fully taxable without any related deduction; in contrast, the portion that covers the debt cost component of WACC results in no taxable income. As described by Ms. Brinkman, "when assets and/or liabilities are financed through the capital structure as a whole, *i.e.*, at a rate equal to the corresponding WACC for that capital structure, the debt portion of WACC recovers an equal amount of interest expense which is deductible for tax purposes." ComEd Ex. 1.0 CORR., at 14:287-93. Just as in every rate case where the full cost of the capital that finances utility assets must be recovered, the portion attributable to equity results in taxable income that must also be recovered, while the portion attributable to debt does not.

Staff witness Mr. Bridal claims that the gross-up of the WACC for the effect of income taxes is not necessary because the reconciliation amount is the difference between two revenue

requirements that were already grossed-up for taxes. Bridal Dir., Staff Ex 1.0 3:62-64. ComEd does not dispute this point.⁶ However, the difference between the two revenue requirements is recorded as additional revenues (or, conversely, a reduction of revenue) to ComEd, which has separate tax impacts. *See* Brinkman Dir., ComEd Ex. 1.0 CORR., 18:377-97; Brinkman Reb., ComEd Ex. 3.0, 8:156-60. Simply put, the fact that the principal amount on which interest will be earned reflects taxes related to that principal does not affect the fact that the interest itself will result in still greater tax that is not reflected in the separate gross-up. Mr. Bridal's claim that the revenue requirements already consider taxes completely disregards the tax effects related to the interest. Without the income tax gross-up on the equity portion of the WACC, these additional revenues are not grossed up for the impact of income taxes and ComEd will be unable to recover or refund its full carrying costs related to the reconciliation. Brinkman Dir., ComEd Ex. 1.0 CORR., 19:391-97. Such a result conflicts with EIMA's intent to allow ComEd the opportunity to recover its actual costs.

Staff's view that recognizing EIMA tax costs is inconsistent with Commission practice in rider reconciliations (Bridal Dir., Staff Ex 1.0, 3:64-6, 4:79 – 5:109) is inapposite. Traditional reconciliation proceedings and the EIMA reconciliation process are not similar. EIMA ratemaking is aimed at providing accurate recovery of rate year revenue requirements. Meanwhile, other "reconciliations" do not involve a reconciliation of ComEd's full delivery services revenue requirement or provide for the recovery of interest set at the WACC. A better example in ComEd's case is the cash working capital calculation in ComEd's purchased electricity adjustment rider. There, the cost of capital is grossed up for taxes to account for the full cost of financing the lag (or lead) related to procuring electricity supply for ComEd

⁶ Each revenue requirement included in the reconciliation has appropriately accounted for the income tax costs associated with the allowed return on rate base.

customers. The rate year reconciliation balance is similar in that it is a lag (or lead) on recovery of ComEd's net revenue requirement for an individual rate year and the full cost of its financing should be recovered (or refunded). Brinkman Dir., ComEd Ex. 1.0 CORR., 17:348-54.

Furthermore, the reconciliations Staff points to are efforts to ensure complete recognition in rates of a utility's full revenue requirement, which EIMA not only intends but mandates. Brinkman Reb., ComEd Ex. 3.0, 8:166 – 9:190. For example, Staff focuses on rider recovery of Water/Sewer Qualified Infrastructure Plant Surcharges (“QIPS”) in support of its claim. While QIPS involves recovery of specific additional plant investments (Bridal Dir., Staff Ex. 1.0, 5:92-4) it does not reconcile the revenue requirement and does not provide for full recovery of all reasonable and prudent costs of service (including tax costs). The only situation that is truly comparable to the instant situation is the application of WACC in the context of establishing a utility's full revenue requirement; it is not contested that WACC is grossed up for income tax effects in that context.

Finally, Staff points to the Commission's decisions in Docket Nos. 11-0721 and 12-0321. While those dockets did not approve an interest rate that had an equity component and thus had no occasion to consider taxes, Staff makes much of the fact that ComEd did not gross-up the proposed interest rate in those dockets. Bridal Dir., Staff Ex. 1.0, 6:114-20. ComEd does not dispute this fact; and the evidence shows that to have been an oversight, not a conscious decision. Fruehe, ComEd Ex. 2.0, 2:42 – 4:79. Moreover, ComEd (as it has consistently argued, for better or worse) could not change the formula in Docket No. 12-0321, as that was an update docket. *See* Fruehe Dir., ComEd Ex. 2.0, 3:49 – 4:79. ComEd's actual and longstanding position on this issue is quite clear. In previous rate cases stretching back decades, ComEd consistently grossed-up the equity return component of WACC for purposes of recovering the

costs of assets financed with its full capital structure. *Id.* On this last point, no party claims otherwise.

The AG simply defies the statute and the resolutions, claiming that they do not “require consideration of the Company’s incurred actual incremental financing costs or incremental income taxes arising from specific financing decisions that may be made by the utility.” Brosch Dir., AG Ex. 1.0 REV., 7:154-60. This argument contradicts the purpose of EIMA as a whole, which is to “reflect actual costs as if they were known when rates charged during each rate year were set” (Brinkman Reb., ComEd Ex. 3.0, 10:206-08) and the specific language of the resolutions, quoted above, that ComEd be made whole. Moreover, EIMA directs that the rate formula use the WACC approved by the Commission that reflects the utility’s actual capital structure – ComEd’s capital structure is comprised of both debt and equity financing, and using divergent financing, as the AG suggests, would contravene this capital structure. *Id.* at 10:215 – 11:217.

In a similar vein, the AG argues that ComEd is “free to actually finance any changes in the reconciliation balance using any form of capital it desires, including a mix of debt or equity.” Brosch Dir., AG Ex. 1.0 REV., 7:155-57. However, as stated above, ComEd finances the reconciliation balance with its approved capital structure. It would be improper to treat all of ComEd’s financing costs as if they resulted from debt, because: (1) the reconciliation balance does not represent discrete assets that can be financed, but instead is a mathematical share of the total final reconciliation revenue requirement that is financed by all of the financing elements included in the WACC; and (2) prior findings that ComEd could finance its reconciliation balance with debt alone were rejected by PA 98-0015. Brinkman Dir., ComEd Ex. 1.0 CORR., 15:299-307.

Finally, Staff, the AG, and CCI ask the Commission to commit reversible error by arguing that the Commission should rely on whether Ameren Illinois Company grosses-up the interest rate to be applied to the reconciliation balance. *See* Bridal Dir., Staff Ex. 1.0, 6:121-27. ComEd is not a party to that proceeding, and the facts and circumstances of ComEd's Commission-approved formula rate are neither an issue in that proceeding nor within the scope of that proceeding. The Commission must decide this case "exclusively on the record for decision" in this case. 220 ILCS 5/10-103. ComEd should not be denied the right to recover its costs here simply because Ameren's formula appears not to consider these tax impacts.

The legislature made absolutely clear that the purpose of EIMA was to "[p]rovide 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)(1) (emphasis added). The statutorily specified "intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates ... with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been *had the actual cost information for the applicable calendar year been available at the filing date.*" 220 ILCS 5/16-108.5(d)(1) (emphasis added). Interest calculated at a utility's WACC without accounting for tax effects in the calculation does not place the utility in the position it would have occupied "*had the actual cost information for the applicable calendar year been available at the filing date.*" *Id.* (emphasis added).

For all the foregoing reasons, the Commission should reject proposals to change the computation of interest on the reconciliation balance in ComEd's Commission-approved formula rates to provide for the use of WACC without income tax impacts.

B. Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Calculate the Section 16-108.5(c)(5) Return on Equity (“ROE”) Collar as Authorized by the Public Utilities Act?

The approved rate formula uses a year-end capital structure based on ComEd’s FERC Form 1 balances for all purposes, including calculating the ROE Collar. It also uses rate base components, including plant in service, uniformly based on those year-end balances. This approach is internally consistent, financially sensible, and produces meaningful results.

ComEd calculates the applicable revenue requirements and reconciliation using a year-end rate base as required by PA 98-0015, including the following codified as Section 16-108.5(d)(1):

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year.”

Id. at 10:190-92; 220 ILCS 5/16-108.5(d)(1). PA 98-0015 superseded prior rulings on this subject, and clearly established that the year-end rate base is the only permissible rate base to use when calculating the applicable revenue requirements and reconciliation. Brinkman Reb., ComEd Ex. 3.0, 3:68-9.

Although the words “year-end” do not literally appear within Section 16-108.5(c)(5), they are incorporated by reference through the requirement in that the earned rate of return on common equity be calculated “consistent with this Section” – which refers to Section 16-108.5 of the Act. 220 ILCS 5/16-108.5(c)(5). To review the relevant statutory language, Section 16-108.5(c)(5) provides, in part,⁷ as follows:

⁷ The quoted language addresses the scenario where the utility’s earned rate of return on common equity is more than 50 basis points *less* than its authorized return on common equity. This same language is repeated in

If the participating utility's earned rate of return on common equity related to the provision of delivery services for the prior rate year (calculated using costs and capital structure approved by the Commission as provided in subparagraph (2) of this subsection (c), *consistent with this Section*, in accordance with Commission rules and orders ...) is more than 50 basis points less than the return on common equity calculated pursuant to paragraph (3) of this subsection (c) ... then the participating utility shall apply a charge through the performance-based formula rate that reflects an amount equal to the value of that portion of the earned rate of return on common equity that is more than 50 basis points less than the rate of return on common equity calculated pursuant to paragraph (3) of this subsection (c) ... for the prior rate year, adjusted for taxes.

220 ILCS 5/16-108.5(c)(5) (emphasis added). Section 16-108.5(c)(2) requires that the formula rate reflect a year-end capital structure:

(2) Reflect the utility's actual *year-end* capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law

Id. at (c)(2) (emphasis added). Section 16-108.5(d)(1) provides that the reconciliation and reconciliation revenue requirement shall be determined using a year-end rate base:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (*determined using a year-end rate base*) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year.

Id. at (d)(1) (emphasis added). That section further specifies that the intent of the reconciliation is to reconcile the revenue requirement initially included in rates with the actual revenue requirement determined using a year-end rate base:

Notwithstanding anything that may be to the contrary, *the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates* for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, *with what the revenue requirement determined using a year-end rate base for the applicable calendar year*

Section 16-108.5(c)(5) with one minor change to address the scenario where the utility's earned rate of return on common equity is more than 50 basis points *higher* than its authorized return on common equity. *Id.*

would have been had the actual cost information for the applicable calendar year been available at the filing date.

Id. The law is clear: the ROE collar calculation would not be consistent with the requirements of Section 16-108.5 if it were based on anything other than a year-end rate base. In light of this solid statutory basis for use of a year-end rate base for the ROE collar, Mr. Effron's argument that EIMA does not specifically *reject* use of an average rate base is feeble at best.

Moreover, even aside from the statutory provisions supporting use of the year end rate base, the AG's advocacy of an "average rate base" when calculating the earned ROE for the purpose of this collar calculation. (Effron Dir., AG Ex. 2.0 REV., 4:69-76)⁸ would create a mismatch when calculating ComEd's earned ROE. There is no average rate base in the approved formula, in ComEd's FERC Form 1, or in the statute, and the average rate base does not equate to the year-end rate base for any year. The use of an average rate base would result in an "artificially inflated earned ROE by reducing the amount of rate base financed by both debt and equity resulting in both a higher net income due to a reduction in long-term interest expense and higher ROE given the higher income (numerator) and the lesser amount of equity (denominator). This creates an artificial impression that ComEd's earnings were further outside the ROE Collar band than they actually were." Brinkman Dir., ComEd Ex. 1.0 CORR., 11:220 – 12:229. Alternatively, if ComEd's average rate base is higher than its year-end rate base, the ROE is artificially deflated when compared to the value calculated utilizing a year-end rate base. *Id.* at 12:229-31.

⁸ Mr. Effron also raised this issue in ComEd's FRU proceeding in Docket No. 13-0318. In that docket, Mr. Effron challenged the calculation of the ROE Collar as set forth in ComEd's Commission-approved formula. In response, ComEd demonstrated that although the issue of the calculation of the ROE Collar was outside the scope of the FRU Proceeding, Mr. Effron's proposal was inconsistent with the approved rate formula and should be rejected. *See* AG Ex. 2.0 REV., 11:228 – 14:312, Docket No. 13-0318; ComEd Init. Br. at 67-69.

Although Mr. Effron claims that his proposal would not modify the rate base used to establish the initial revenue requirement or the rate base used in the reconciliation (Effron Reb., AG Ex. 4.0, 1:23 – 2:26), this disregards the ultimate affect that this change would have. As ComEd witness Ms. Brinkman stated in her testimony, “it makes no sense to base an earnings test like the ROE Collar on a method of measuring rate base at odds with the method used to set the initial revenue requirement, the actual-cost reconciliation revenue requirement, and ultimately the charges applicable to customers.” Brinkman Reb., ComEd Ex. 3.0, 4:83-6. Instead, Mr. Effron’s proposal would achieve the same result clearly rejected by PA 98-0015 – to replace the year-end rate base in both the collar calculation and the reconciliation revenue requirement. This result is further explained in Ms. Brinkman’s testimony:

This [result] is because the reconciliation year “true up” contains two components, as seen in Sch FR A-1 of the rate formula: the reconciliation balance plus interest (ComEd Ex. 1.03 Sch FR A-1 line 24) and the ROE Collar Adjustment (ComEd Ex. 1.03 Sch FR A-1 line 35). The former – the reconciliation balance – is the difference between the actual costs for the reconciliation year, in this case 2012, and the revenue requirements in effect for that year, which even Mr. Effron concedes must be calculated using year-end rate base data. But the ROE Collar adjusts the final amount to recover or refund, and that collar adjustment relates entirely to the reconciliation year.

ComEd Ex. 4.0, 3:56–63.

Lastly, Mr. Effron claims that PA 98-0015 nowhere expressly rejects the use of an average rate base in the ROE collar calculation, and uses this as a justification for his reliance on the use of the average rate base. AG Ex. 6.0, 1:14-2:28. Such a claim misconstrues the PUA as explained above. Moreover, the House and Senate Resolutions incorporated in part by reference in Public Act 98-0015 make absolutely clear that nothing other than a year-end rate base may be used with respect to EIMA:

WHEREAS, The Energy Infrastructure Modernization Act also provides that the final *year-end* cost data filed in FERC Form 1 should generally be used to determine rates; and

WHEREAS, No statutory authority was given to the Illinois Commerce Commission to set rate base and capital structure using average numbers that do not represent final *year-end* values reflected in the FERC Form 1, and the Illinois Commerce Commission's use of such average is contrary to the statute;

RESOLVED ... that we express serious concerns that the Illinois Commerce Commission Order, entered on May 29, 2012 in Commission Docket No. 11-0721, fails to reflect the statutory directives and the intent of the Illinois General Assembly by: ... (3) determining rate base and capital structure using an average, rather than the *year-end* amounts as reflected in FERC Form 1;

Senate Resolution 821, 97th General Assembly, at 3, 4-5; House Resolution 1157, 97th General Assembly, at 3, 4-5; 220 ILCS 5/16-108.5(k).

Mr. Effron's proposal would require that the Commission disregard the mandates of PA 98-0015 as well as ComEd's Commission-approved tariffs and formula. ComEd's formula rate uniformly uses the year-end rate base reflecting amounts from the reconciliation year FERC Form 1 as an input. Mr. Effron's position is inconsistent with the EIMA ratemaking and the approved formula and was rejected by PA 98-0015, and would result in a mismatch when calculating ComEd's earned ROE; therefore, it must be rejected.

C. Do the Tariffs Filed on May 30, 2013 by ComEd Correctly Reflect the Appropriate Tax Treatment in Calculating Interest on the Reconciliation Balance in the Formula Rate Tariff as Authorized by the Public Utilities Act?

The approved rate formula properly reflects the tax treatment for interest on reconciliation balances. Deferred income taxes related to the reconciliation are not netted against the reconciliation *before* interest is calculated: it would be incorrect to do so. Prior to collecting the reconciliation balance, ComEd has received no tax benefit. The cash receipts, as well as the tax payment, are deferred.

Witnesses for the AG and CCI propose an unlawful and improper reduction to the reconciliation balance for purposes of calculating the interest on that balance. *See* Brosch Dir., AG Ex. 1.0 REV., 9:197 – 17:390; Effron Dir., AG Ex. 2.0 REV., 7:150 – 11:27; Gorman Dir., CCI Ex. 1.1, 5:81 – 9:146. Specifically, Mr. Brosch, Mr. Effron and Mr. Gorman propose that the accumulated deferred income tax (“ADIT”) related to the reconciliation balance be netted against the reconciliation balance before calculating the interest amount. Their proposal is inconsistent with and violates the existing formula and would result in a reconciliation balance dramatically different from that specified by the formula’s calculations. *See* Brinkman Dir., ComEd Ex. 1.0 CORR., 19:398 – 28:573. The Commission also rejected that argument in Docket No, 11-0721, and nothing has changed since that time to warrant its resurrection. Indeed, nothing in PA 98-0015 would support any change in the disposition of this ADIT argument.

No party does, or can, dispute the fact that ComEd did not receive any cash from ratepayers in 2012 related to the underlying reconciliation balance. However, ComEd has incurred carrying costs – that is, the time value of money – related to the full 2012 balance and thus, has recorded a deferred tax liability. Because the rates in effect did not recover those carrying costs, ComEd should earn an interest rate on that financing until it is able to collect the revenues related to those costs in 2014. Brinkman Dir., ComEd Ex. 1.0 CORR., 23:459-66. To put it another way, taxes related to the reconciliations are deferred because the revenue is deferred, and that deferral provides no tax benefit to ComEd. This deferred tax liability represents an amount that ComEd must pay in the future, and is an amount that ComEd has not recovered from customers through rates – ComEd has no offsetting tax benefit with which to fund these carrying costs. Brinkman Reb., ComEd Ex. 3.0, 12:256-59.

The AG argues that “the incremental actual invested capital associated with reconciliation over- or under- recoveries is impacted by income tax that is applicable to cash revenue whenever they are collected by the utility without any offsetting deductible expense amounts,” and, therefore, “given the lower after-tax investment required from investors because of these income deferral benefits, the amount of interest properly applied to the reconciliation balance should be reduced accordingly.” Brosch Dir., AG Ex. 1.0 REV., 9:203 – 10:223; *see also* Effron Dir., AG Ex. 2.0 REV., 9:184-90; Gorman Dir., CCI Ex. 1.1, 6:89-90. This adjustment should be rejected.

Preliminarily, it is not sufficient for the AG to conclude that deferred taxes should reduce the revenue requirement simply because, generally, accumulated deferred income taxes are deducted from a utility’s rate base. Brosch Dir., AG Ex. 1.0 REV., 15:329-30. The deferred taxes at issue here are fundamentally different from “typical” ADIT – although the ICC does routinely recognize ADIT liability balances as rate base reductions, this only occurs when the ADIT liability results in a cash benefit to the utility in lower taxes paid in the current year. Brinkman Reb., ComEd Ex. 3.0, 13:267-69. These lower taxes create a tax benefit to the utility, which then results in cash available to fund rate base investments. *Id.* at 13:269-70. Here that is not the case. Despite the AG’s claims, the reconciliation amount is not recovered by the utility until a later year and thus produces no current cash benefit; in simple terms nothing exists against which to “net” the deferred taxes. Brinkman Reb., ComEd Ex. 3.0, 13:270-74; *see* Brosch Dir., AG Ex. 1.0 REV., 10:211-226; Effron Dir., AG Ex. 2.0 REV., 9:184-190.

Witnesses for the AG and for CCI wrongly argue that the ADIT liability on the reconciliation is a tax benefit, and that taxes currently payable are lower because of the reconciliation. *See* Brosch Reb., AG Ex. 4.0, 5:92-97; Gorman Reb., CCI Ex. 2.0, 4:62-68. As

stated above, the ADIT liability does not represent a current cash tax benefit. Instead, it represents a future tax liability. Brinkman Sur., ComEd Ex. 4.0, 13:275-84. Moreover, taxes that are currently payable are not impacted by the reconciliation – they are simply lower than they would have been had ComEd received more revenue and been paid the reconciliation balance earlier. *Id.* at 13:284 – 14:291.

The AG further argues that changes in ADIT provide incremental cash flow to utilities through the change in timing of the payment of cash income taxes associated with such tax deferrals. Brosch Dir., AG Ex. 1.0 REV., 15:345-47. According to Mr. Brosch, even when utilities are in a Net Operating Loss (“NOL”) carryforward position, the size of the NOL in each tax year is directly impacted by changes in the reconciliation balance regulatory asset, and the resulting NOL deferred tax asset is included in rate base to directly impact utility rates. *Id.* at 15:347 – 16:351. This argument wrongly interprets the effect of the NOL and should be rejected. According to Ms. Brinkman, the NOL carryforward was generated primarily by the 50% bonus depreciation deduction allowed under the Tax Relief Act of 2012. Among other things, the Tax Relief Act allowed companies to accelerate depreciation expense treatment on the tax return, which led to lower taxes for those companies in the near term. The purpose of the Act was to create an opportunity for companies to use their tax savings to stimulate the economy. Brinkman Reb., ComEd Ex. 3.0, 13:277 – 14:282. Mr. Brosch correctly states that ComEd is currently in a NOL carryforward position, but misinterprets the effect of this tax benefit. Ms. Brinkman further explains the effect of the NOL carryforward position:

Without 50% bonus depreciation in 2012, ComEd would have reflected taxable income. Because it will reduce taxes in a future period, by applying this net operating loss to future taxable income, the NOL carryforward is a deferred tax asset. Under the GAAP Accounting Standards Codification (“ASC”), specifically ASC 740, ComEd has reflected a deferred tax asset of \$25 million (jurisdictional portion) for the NOL on WP 4, line 20 of ComEd’s 2013 formula rate template

(Docket 13-0318, ComEd Ex. 14.02). The bonus depreciation itself, however, creates a deferred tax liability because there is a temporary difference related to accelerated depreciation, under the bonus depreciation rules, and is included on ComEd Ex. 14.02, WP 4, line 51. For book purposes, ComEd is recording depreciation expense at a slower rate than for tax purposes, thus ComEd is receiving a benefit on its tax return now before reflecting the full expense on its books. The NOL deferred tax asset nets against the bonus depreciation deferred tax liability. Once the NOL is utilized this deferred tax asset is eliminated.

Brinkman Reb., ComEd Ex. 3.0, 14:282-94. Thus, ComEd's NOL carryforward in the current year is not directly impacted by changes in the reconciliation balance regulatory asset. Further, in ComEd's response to an AG data request in Docket No. 13-0318, ComEd expressly stated that the "deferred tax asset related to the Federal NOL does not affect the deferred income tax position related to the regulatory asset for the under-recovery of reconciliation amounts." ICC Docket No. 13-0318, AG 4.03(d).

Finally, ComEd notes that the same relationship exists where the reconciliation results in an over-recovery. If less than the full reconciliation balance accrued interest, then customers – in cases where the utility over-collected prior to reconciliation – would receive interest on only about 60% of the money they would have "advanced" to the utility. Brinkman, Tr. 61:20 – 62:7. That approach would not fully credit to customers the interest on funds that they have provided, just as the intervenors ADIT argument would deprive ComEd out of recovering interest on a major portion of its deferred revenues.

Accordingly, ComEd ought to be allowed to recover interest, at the allowable rate (WACC), on the full reconciliation balance, not on only the balance net of deferred income taxes. The proposals of the AG and CCI are inconsistent with EIMA and the approved rate formula, and should be rejected.

III. IMPLEMENTATION OF RATE FORMULA CHANGES, IF ANY

There is no basis for the Commission to make any change in ComEd's approved rate formula. However, in the event that there were to be any changes made, those changes should be given effect both prospectively and retrospectively back through the decision in Docket No. 11-0721, in the form of a single rolled-up credit or charge (as the case may be) applicable in 2014. The reasons are straightforward.

First, "[b]ecause PA 98-0015 changes rates both prospectively and retrospectively, the Commission's interpretation of the law should also be given effect both prospectively and retrospectively." Brinkman Reb., ComEd Ex. 3.0 18:376-78. PA 98-0015 itself:

changed EIMA ratemaking not only prospectively, but retrospectively as well. The effect of each of the clarifications and changes required by PA 98-0015 on prior years' revenue requirements and rates were assessed and ComEd both collected from, and refunded to, customers the resulting differences. Customers and utilities not only saw different rates going forward, but were put in the financially equivalent position to where they would have been had the Commission applied EIMA as clarified by PA 98-0015 from the beginning.

Brinkman Reb., ComEd Ex. 3.0 17:361-67.

This is an investigation of a rate formula to determine if it complies with PA 98-0015. If the Commission determines here that it decided Docket No. 13-0386 incorrectly, and that PA 98-0015 can only be correctly implemented in some other way, then by PA 98-0015's own terms the effect of that ruling should be retroactive.

Moreover, this investigation is not premised on some subsequent change in the facts or law. Every argument for a change, no matter how meritless, is an argument that the Commission was wrong to approve ComEd's filed rate formula to begin with. Failure to give any change premised on such an argument both retroactive and prospective effect would produce a fundamental inconsistency because that decision "will reflect a changed view on how PA 98-

0015 should have been interpreted from the beginning, not because PA 98-0015 meant one thing for six months and something else thereafter.” *Id.* at 18:371-75. If the Commission were to do otherwise, it would create a situation where “ComEd’s net revenue requirement and rates, both in 2014 and in years before, will be based on a revenue requirement calculation that the Commission now disavows and that,” under its new view PA 98-0015, the General Assembly directed the Commission to correct. *Id.* at 18:378-81.

The evidence on this subject is unanimous. The only other witness who testified on this subject, AG witness David Efron, concurred with ComEd’s position. Efron Sur., AG Ex. 6.0, 2:38 – 3:47. Mr. Efron also made clear in his agreement that the effect of any charges or credits “including any retroactive effect on the ROE collar calculation and on the reconciliation, should be reflected in the Company’s rates as of January 1, 2014.” *Id.* at 3:47-49.

IV. CONCLUSION

The record contains no basis on which to overturn the Commission’s decision in *Commonwealth Edison Co.*, ICC Docket No. 13-0386, and cannot support ordering ComEd to make any revision to the rate formula approved therein. The investigation should be closed.

Dated: November 1, 2013

Respectfully submitted,

COMMONWEALTH EDISON COMPANY

By: 

One of its attorneys

Thomas S. O'Neill
Senior Vice President & General Counsel
COMMONWEALTH EDISON COMPANY
440 S. LaSalle Street, Suite 3300
Chicago, Illinois 60605
(312) 394-5400
thomas.oneill@exeloncorp.com

Anastasia M. O'Brien
Richard G. Bernet
10 South Dearborn Street, 49th Floor
Chicago, Illinois 60603
anastasia.obrien@exeloncorp.com
richard.bernet@exeloncorp.com

E. Glenn Rippie
John E. Rooney
ROONEY RIPPIE & RATNASWAMY LLP
350 West Hubbard Street, Suite 600
Chicago, Illinois 60654
(312) 447-2800
glenn.rippie@r3law.com
john.rooney@r3law.com

David M. Stahl
Mark R. Johnson
EIMERSTAHL LLP
224 South Michigan Avenue, Suite 1100
Chicago, Illinois 60604
(312) 660-7600
dstahl@eimerstahl.com
mjohnson@eimerstahl.com

Attorneys for Commonwealth Edison Company