

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS COMMERCE COMMISSION)	
On Its Own Motion)	
)	
)	
)	Docket No. 13-0553
COMMONWEALTH EDISON COMPANY)	
)	
Investigation of tariffs approved in)	
Docket No. 13-0386)	

**DRAFT ORDER OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS,
CITY OF CHICAGO, AND CITIZENS UTILITY BOARD**

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Now comes the Illinois Industrial Energy Consumers (“IIEC”), City of Chicago (“City”) and Citizens Utility Board (“CUB”) (collectively, “CCI”), pursuant to Rules of Practice of the Illinois Commerce Commission (“ICC” or “the Commission”), 83 Ill. Admin. Code Part 200.810, and pursuant to the briefing schedule established by the Administrative Law Judges (“ALJs”), to hereby file this Draft Order in the above-captioned proceeding. This Draft Order is organized pursuant to the Joint Outline utilized by parties in the Initial and Reply briefs. For the reasons set forth in the Initial and Reply Briefs of CCI, the Commission should adopt the Analyses and Conclusions set forth herein.

II. PA 98-15 COMPLIANCE

COMMISSION ANALYSIS AND CONCLUSIONS

This proceeding was initiated under provisions of the PUA, including the formula rate provisions, that provide the Commission with adequate authority to reconsider, modify or rescind any part of its prior order in Docket 13-0386. See Initiating Order; 220 ILCS 5/10-113(a); 220 ILCS 5/16-108.5(c). Taken together, those provisions effectively neutralize the constraints of the “structure and protocols of the performance-based formula rate” provision of the formula rate law, insofar as that provision is offered as a limitation on the Commission’s actions in this proceeding. There also is no need for the Commission to concern itself -- for the purpose of

determining its authority in this case -- with the scope of the its tariff and revenue requirement approvals in Docket 13-0386. Our decisions herein are based on the provisions of the PUA and the record before use, not the submissions in a case whose conclusions this Commission opened this proceeding to revisit.

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?

CCI Position

CCI contend that ComEd has applied an incorrect interest rate to an inflated reconciliation balance to calculate interest. CCI observe that ComEd “grossed-up” the interest rate equal to its WACC of 6.91% for taxes, increasing the interest applied in reconciliation by 276 basis points, to 9.67%. CCI Ex. 1.1 at 4:59. CCI state that ComEd uses an interest rate higher than the ComEd WACC specified in the Formula Rate Law. Using a rate other than one “equal to” ComEd’s WACC in its formula rate calculations violates subsection 16-108.5(d)(1) of the PUA and is in contravention of appropriate accounting practices.

1. The PUA Prohibits a Gross-Up

CCI maintain that ComEd has overstated its interest rate in direct contravention of the PUA. The PUA specifically provides for interest on the reconciliation balance to be “calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year.” 220 ILCS 5/16-108.5(d)(1) (emphasis added). CCI aver that the reconciliation interest rate is intended to acknowledge that, because ComEd under-collected in 2012, it should be compensated for the time value of the money on the cash investment in the under-collection. CCI Ex. 1.1 at 4-5:65-69.

CCI contend that there is no ambiguity in the statute. The weighted average cost of capital (“WACC”) (which in this case is 6.91%) is the interest rate that must be used, say CCI. *Id.* at 4:55-57. CCI argue that ComEd has improperly “grossed up” or “factored-up” the Company’s WACC, allegedly for the effect of income taxes, and used in its reconciliation calculations an interest rate of 9.67%, rather than its actual WACC. *Id.* at 4:59. ComEd claims that “[t]he gross up accounts for taxes that will need to be paid as a result of the cash collected for the reconciliation...” ComEd Ex. 1.0 Corr. at 14:281-282. CCI contend that ComEd is wrong. The Company has not calculated an interest rate equal to its WACC, as required by the Formula Rate, and the tax effect that ComEd claims to offset, does not exist. CCI maintain that the Company’s attempts to collect a higher interest rate than is authorized to carry the cost of the reconciliation balance should be rejected.

CCI note that ComEd admits that the Formula Rate Law does not expressly provide for a gross-up of its WACC interest rate. ComEd Init. Br. at 4. CCI aver that ComEd treats that absence of its desired calculation as license to search for its preferred result in speculations about legislative intent, instead of following the explicit directive of the General Assembly in the Formula Rate Law. The proper first step of statutory construction is to “always begin with the

language of the statute which is the most reliable indicator of legislative intent.” *People v. Marshall*, 242 Ill. 2d 285, 292 (2011) (internal quotations omitted). Here the statutory language is clear; the interest rate is to be equal to the WACC, not in excess of the WACC, and no gross-up is authorized. CCI point out that, where a legislative enactment provides an unambiguous directive, the law requires that the legislature’s words be given effect; searches for deeper -- or more advantageous -- meaning are neither required nor permitted. *Michigan Avenue Nat’l Bank v. County of Cook*, 191 Ill.2d 493, 503-504 (2000); *Ill. Graphics v. Nickum*, 159 Ill.2d 469, 479 (1994).

CCI contend that the Formula Rate Law provides the precise interest rate to be used, and ComEd improperly pursues alternative meanings that drive up its revenue. The words of the statutory provision at issue, however, identify a specific number, for a mathematical calculation, and nothing more. CCI argue that there is no need for speculation about how the General Assembly derived the number, the nature of utility reconciliation financing, or tax implications. CCI contend that whether the legislature considered any or all of those topics, it resolved them all in the determination of the appropriate interest rate it expressed in the words of the statute.

CCI’s response to ComEd’s contention that “[t]here is nothing new or novel about WACC gross-ups,” asserts that the Formula Rate Law amendments (a) use an interest rate, not a WACC, and (b) do not require or permit a gross-up of the WACC rate. ComEd Init. Br. at 3-4. In addition, CCI point out that the Commission has consistently defined the term “weighted average cost of capital” over a period of almost three decades as:

. . . the sum of the cost of the components of the capital structure, i.e., debt, preferred and preferred stock, and common equity, weighted by their relative proportions in the capital structure.

Commonwealth Edison Company, Dkts. 87-0427; 87-0169, 88-0189; 88-0219, (Cons.), Order, Dec. 30, 1988, 1988 Ill. PUC Lexis 11 at 87; *see also*, *Commonwealth Edison Company*, Dkts. 87-427, 87-0169 (cons.); 88-0189; 88-0219; 88-0253, on Remand, Order, March 8, 1991, 1991 Ill. PUC Lexis 145 at 345. Specifically, CCI note, the Commission’s definition of WACC does not include a gross-up, consistent with the absence of a WACC gross-up in the Formula Rate Law, as amended.

CCI argue that, because the statute requires that interest on the appropriate reconciliation balance be “calculated at a rate equal to the utility’s weighted average cost of capital,” (220 ILCS 5/16-108.5(d)(1) (emphasis added)), whether WACC gross-ups “have been used... for decades” (ComEd Br. at 4) is irrelevant. CCI note that the Commission is not constructing a WACC on its own; it is applying an interest rate explicitly required by law, one that is equal to, not in excess of, ComEd’s WACC. In addition, say CCI, the legislature was presumably aware of the Commission’s historical practices regarding interest rates (no gross-up). Yet, when it amended the Formula Rate Law to clarify the appropriate reconciliation interest rate, it did not add “grossed-up for the effect of income taxes.” Because the statute includes no gross-up provision and the Commission’s own definition of WACC also includes no gross-up, CCI contend, there is no basis for ComEd’s gross-up of the mandated interest rate, to an interest rate that is not equal to the WACC, but greater than the WACC.

CCI provided an illustrative example to explain the meaning of “grossing-up” (also referred to as “factoring-up”). If an employer offers an employee \$100,000 for one year, assuming that employee is in the 30% tax bracket, the employee will only actually take home \$70,000. In order to take home \$100,000, the company would have to pay the employee \$143,000 (assuming still a 30% tax bracket). The \$143,000 amount is thus the “grossed-up” amount that nullifies the effect of income taxes. However, absent an agreement that the compensation would be grossed-up for income taxes, it is not reasonable for the employee to expect to receive \$100,000 net income. In this case -- assuming, *arguendo*, that income taxes actually would apply¹ -- unless the PUA expressly prescribed such an effect for interest received, CCI contend it would not be reasonable to impose a gross-up on ratepayers.

In ComEd’s initial formula rate setting case, and its first reconciliation, the Commission determined that the appropriate interest rate to apply to the reconciliation balance is the Company’s short term debt rate. ICC Docket No. 11-0721, Order on Reh’g, (Oct. 3, 2012) at 36. CCI note that in those cases, ComEd did not propose to “gross-up” the interest rate determined, and the Commission did not order any such adjustment

CCI point out that ComEd’s own past applications of the Formula Rate Law conform to the interpretation and application proposed by the ratepayer advocates and Staff in this case. In ICC Docket Nos. 11-0721 and 12-0321, ComEd did not advocate for or apply an income tax gross-up to the reconciliation balance. CCI note that the issue of grossing-up the interest rate was never mentioned in the testimonies of Mr. Hemphill or Ms. Houtsma in ICC Docket Nos. 11-0721 or 12-0321, and the Company admits that it did not propose such a gross-up at that time. Staff Ex. 1.0 at 6:114-117; ComEd Ex. 2.0 at 3:49-51, 58-59. ComEd claims that was an “oversight.” *Id.* at 3:49-53. Given the amount of time and energy ComEd expended on the Formula Rate Law, PA 98-15 and in all of the formula rate proceedings under that law, CCI contend it is simply not credible that ComEd simply forgot to implement such a significant adjustment, which ComEd now claims was there all along. CCI state that it is more likely that ComEd realized, after PA 98-15 was passed, that it could collect an even bigger return if it shoehorned its “gross-up” change into the hurried review of the tariff changes and revised revenue requirement ordered by PA 98-15 in Docket No. 13-0836. Its strategy almost worked, say CCI. Staff and the Commission had neither the time nor resources to discover the unauthorized changes – not all of which are readily apparent – until after the tariffs had been approved. However, note CCI, this investigation is the Commission’s opportunity to right that wrong, and to assure ratepayers that it can remedy such missteps, whether they are simple error or bad faith changes.

Following those earlier cases, CCI observe, the General Assembly enacted PA 98-15 as “a restatement and clarification” of the Formula Rate Law on several contested issues, including the appropriate reconciliation interest rate. The General Assembly clarified that the applicable reconciliation interest rate is “equal to” ComEd’s WACC. Because of the General Assembly amended specific, select provisions of EIMA, CCI argue, if the General Assembly intended for the reconciliation interest rate to be grossed-up for taxes, it would have included that language in PA 98-15. However, CCI note that not one of the three iterations of that provision -- the original

¹ See subsection 2. below regarding offsetting tax deductions.

language of Public Act 97-616, the updated language of PA 97-646, or the updated language of PA 98-15 -- mention any gross-up calculation or any specific reconciliation interest rate other than the WACC.

CCI further note that the other participating utility under the Formula Rate Law, Ameren Illinois Company's ("Ameren") electric distribution service, correctly calculated the interest on its reconciliation balance consistently with all past applications of the reconciliation interest provision and the language of the Formula Rate Law – that is, without any “gross-up” adjustment—using its actual WACC and nothing more. CCI Ex. 1.1 at 5:72-76 (*citing* ICC Docket 13-0301); 5:75-76 (Ameren did not adjust the interest rate for income tax). CCI argue that Ameren's compliance with the consistent interpretation of all parties except ComEd confirms that there is no ambiguity in the statute.

2. Tax Deductions Offset the Income Tax So That None Is Owed

CCI aver that there are no income tax impacts that need to be considered in this case. CCI witness Mr. Gorman testified that it is commonly understood in the industry that interest expense is not grossed up for income tax because it is tax deductible. CCI Ex. 2.0 at 2:33-35. CCI do not contest in this case ComEd's claimed need to finance the reconciliation balance until it is recovered from ratepayers. ComEd Ex. 1.0 Corr. at 12:284-249. However, note CCI, there is also no dispute that any debt interest ComEd incurs to finance its operations pending reconciliation is deductible for tax purposes, resulting in no taxable income. *Id.* at 14:290-293.

CCI point out that ComEd's argument assumes that the Company actually does finance the reconciliation balance with a combination of debt and equity. In reality, say CCI, the Company is free to finance any changes in the reconciliation balance using any form of capital it desires – a mix of debt and equity, or solely debt or equity. AG Ex. 1.0 at 7:157-159. Though the statute requires that ComEd receive interest from ratepayers in an amount equal to WACC, CCI aver it includes no requirements on the actual rate at which ComEd must finance its investment in the reconciliation balance. *Id.* at 7-8:159-164. The actual financing decisions are made by the utility. *Id.* at 8:162-164.

CCI demonstrate that the interest ComEd receives on the reconciliation balance compensates the Company for the lost time value of money as a result of under-collecting in 2012. CCI 1.1 at 4-5:66-69. CCI explain that any interest expense incurred by a business is fully deductible in determining taxable income and therefore has no tax impact. AG Ex. 3.0 at 2:34-37. Even assuming ComEd incurs interest at the same rate (WACC) that it recovers from ratepayers, CCI state that the taxable income resulting from incurring and then recovering such interest would be zero. *Id.* at 2:37-40. In other words, the tax deduction ComEd received from incurring interest expense to cover the amount of under-collection should fully offset the revenues received from ratepayers to recover interest on the reconciliation balance. *Id.* at 3:55-60.

CCI point out that ComEd's current position contradicts its previous arguments about this issue. Only one year ago, ComEd argued that the interest rate on the reconciliation balance must be set at a rate equal to its WACC because the WACC is what ComEd actually pays the capital

markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of costs. ICC Docket No. 11-0721, Order on Reh'g at 26 (Oct. 3, 2012). ComEd argued

only an interest rate equal to its weighted average cost of capital (“WACC”) will account for the time value of money... the WACC is what it actually pays the capital markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of its costs. The WACC also reflects the value ComEd receives from the use of the money when it has overestimated its costs.

Id. (emphasis added). CCI contend the passage of PA 98-15 gave ComEd exactly what it stated it wanted– an interest rate equal to the Company’s WACC. But now, suddenly, the WACC alone will leave ComEd “unable to recover or refund its full carrying costs related to reconciliation.” ComEd Init. Br. at 5. CCI argue that despite ComEd’s success in getting PA 98-15 passed, which changed the interest rate applied to the reconciliation balance to equal its WACC, ComEd now argues that interest at the WACC rate alone is not really what the Formula Rate Law intended to implement. CCI contend that the absence of a gross-up in ComEd’s prior proposals hardly seems an “oversight” -- as ComEd now asserts (ComEd Br. at 9). Also absent from ComEd’s argument a year ago is the recent effort to transform an interest rate into a rate of return, note CCI.

CCI state that ComEd does not provide any reasonable explanation why the Commission should allow it an interest rate greater than the statutorily-mandated (and previously, ComEd-requested) WACC. More important, say CCI, ComEd identifies no authority for the Commission to use any reconciliation interest rate that is not “equal to the utility’s weighted average cost of capital.” 220 ILCS 5/16-108.5(k)(3). CCI note that the PUA explicitly states that the WACC is the interest rate to be used, and ComEd’s proposal is plainly inconsistent with that language. Additionally, CCI aver, a gross-up is an inappropriate deviation from the consistent regulatory accounting the Commission uses in its reconciliation proceedings.

COMMISSION ANALYSIS AND CONCLUSIONS

We decline to adopt ComEd’s strained interpretation of the PUA to “gross-up” the statutory interest rate. The PUA specifically provides for interest on the reconciliation balance to be “calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year.” 220 ILCS 5/16-108.5(d)(1) (emphasis added). No “gross-up” was provided for in the Act. ComEd’s proposal would require the Commission to apply an interest rate greater than WACC. The fact that the legislature, in P.A. 98-0015, specified an interest rate, not a return, and unambiguously set WACC as the interest rate to be applied to the reconciliation balance, without any mention of a “gross-up” for the effect of income taxes is determinative.

Further, the evidence in this case demonstrates that, as a factual matter, a “gross-up” is not warranted. ComEd’s concern that income taxes will “take a ‘bite’ out of the interest revenues” ComEd will collect (ComEd Br. at 63-64) ignores the interest deductions ComEd is permitted to take as a result of having to borrow capital to finance the reconciliation. The Commission notes that, in the Rehearing phase of ICC Docket 11-0721, ComEd argued that the interest rate on the reconciliation balance must be set at a rate equal to its WACC because the WACC is what ComEd actually pays the capital markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of costs. ICC Docket 11-0721, Final Order on Rehearing at 26. The passage of P.A. 98-0015 gave ComEd exactly what it told this Commission was the appropriate level of reconciliation interest– an interest rate equal to the Company’s WACC. The Company cannot now, without any credible explanation, claim that the WACC is not necessarily the interest rate used to finance the reconciliation balance. ComEd’s suggestion that the interest on a reconciliation balance is, in part, a return on equity is rejected. That argument for a gross-up (based in part on a return on equity) contradicts the legislative determination that ComEd should receive interest. Such recovery therefore is not authorized by the statute as amended.

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?

CCI Position

CCI contend that ComEd’s ROE calculation should be based on average rate base in the ROE collar calculation, as the Commission has previously determined. CCI note that the ROE collar calculation in Section 16-108.5(c)(5) provides that, if the actual earned ROE for a reconciliation year revenue requirement is more than 50 basis points higher than the ROE allowed under the statutory formula rate for that year (after reflecting penalties imposed for failure to meet metrics and performance goals once those goals and metrics apply), then an adjustment will be made to the net revenue requirement to credit customers for the excess. ComEd Ex. 1.0 at 8:153-163. Similarly, if the actual ROE earned by ComEd, after reflecting prudence and reasonableness disallowances, falls more than 50 basis points below the allowed ROE (after reflecting penalties imposed for failure to meet metrics and performance goals once those goals and metrics apply), an adjustment in the amount of the shortfall will be made to the net revenue requirement in the reconciliation proceeding to recover the deficiency. *Id.*

CCI point out that, prior to the formula rate protocol changes pursuant to P.A. 98-0015, the Commission had determined that identification and recovery of actual costs, with the collar applied on that basis, required a participating utility to use average rate base for the purpose of calculating the reconciliation adjustment. *See* AG Ex. 2.0 at 5:96-106. The ROE collar schedules used to assess ComEd’s earnings used average rate base for the purpose of calculating the collar adjustment. *Id.* While the revised Section 16-108.5(c)(2) explicitly addressed the utility capital structure calculation, it was silent on the calculation of the ROE collar adjustment, CCI aver.

However, CCI note, when ComEd changed the reconciliation rate base from average to year-end to comply with PA 98-15, it also changed Schedule FR A-3 relative to the calculation of the distinct ROE collar calculation described in Section 16-108.5(c)(5), to reflect ComEd's assumption that it also should be calculated using year-end rate base. *See* ComEd Ex. 1.0 at 9:173-181. This modification substantially reduces the ROE collar adjustment for 2012, thereby reducing the amount by which rates would decrease because of ComEd's earnings exceeding the 50 basis point collar. CCI contend this change was not authorized by PA 98-15. Furthermore, say CCI, this change represents an unauthorized, unilateral reversal of the Commission's prior determinations requiring the use of average rate base for the purpose of measuring the ROE collar adjustment. *See* AG Ex. 2.0 at 5:96-106. CCI aver that if ComEd's changes to the calculation of the ROE collar from average rate base to year-end rate base are left unaltered, ComEd would collect revenues that do not reflect the Company's actual costs, resulting in rates that are not just and reasonable under Section 9-101 and 16-108.5(c) of the PUA.

CCI contend that the average rate base for the year, rather than year-end, should be used in the calculation of the earned ROE for the purpose of the collar calculation. CCI rely in part on Mr. Effron's reasoning that applying the common equity ratio to the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. CCI aver that the net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year. To be consistent, say CCI, the common equity balance used in the denominator of the ROE calculation should be the balance of common equity over the course of the year, computed as the average balance over that period. CCI maintain that in times when the common equity balance is growing, using the end of period balance of common equity will understate the actual ROE earned on common equity provided by investors over the course of the year, and in times when the common equity balance is decreasing, using the end of period balance of common equity will overstate the actual ROE earned on common equity provided by investors over the course of a year.

The revisions to the formula rate law effectuated in May 2013 by PA 98-15 amended Section 16-108.5(c)(2) to require use of the year-end capital structure in the revenue requirement formula. CCI contend that ComEd goes too far in boldly claiming that the year-end rate base is the rate base that must be used when calculating the ratio of ComEd's earnings over the year to its prudent and reasonable investment used to provide delivery services over that period. CCI aver that, when the General Assembly enacted PA 98-15, it had the opportunity to "fix" the distinct assessment of actual revenues collected from ratepayers and dollars of dedicated investment against the permissible ROE range. It could have, but did not, specify how to measure the ROE for purposes of calculating the collar adjustment, note CCI. CCI aver that if the General Assembly had intended that to be the case, it could have amended that language also – clearly the General Assembly understood the significance of the term "year-end". It is significant that the legislature chose not to use that term to describe the ROE collar assessment of actual collections and earnings levels, say CCI.

However, say CCI, the amendments did not require use of a year-end rate base in the ROE collar calculation. In fact, note CCI, the collar calculation is separate from the various

determinations involving the Company's revenue requirements (projected or actual) for a given year. CCI contend that unlike those revenue requirement processes, the ROE collar process assesses the effect of ComEd's collected revenues, not its costs. CCI aver that the ROE collar check is a determination of whether the rates in effect for a given year produced a return on equity outside a defined range.

CCI note that ComEd's imputes language into the statute that does not exist by implying a statutory mandate to use year-end rate base to measure its earnings for purposes of the ROE collar. As clear and unambiguous as the statute is in certain places, e.g. with requiring the interest on the reconciliation balance to be calculated at a rate equal to the WACC (though, oddly, ComEd sees ambiguity there, where there is none), CCI note that it is silent with regard to the rate base measurement to use in the calculation of the ROE collar adjustment. CCI aver that the silence of EIMA is clear in ComEd's lengthy and convoluted statutory construction and legislative history arguments attempting to convince the reader that the General Assembly *meant* to say "year-end" in Section 108.5(c)(5), though it did not.

CCI note that Mr. Effron is not making a recommendation regarding the calculation of the reconciliation difference between ComEd's projected and actual revenue requirements, and thus his adjustment in no way has "the effect of replacing the year-end rate base ... values utilized in the reconciliation calculation with an average rate base" as Ms. Brinkman erroneously claims. ComEd Ex. 1.0 at 11:209-211. Nor, CCI aver, does AG witness Effron challenge the ratemaking principle that utilities "must have the opportunity to earn returns commensurate with capital market demands." ComEd Ex. 1.0 at 11:213-215. CCI state that Mr Effron's proposal does not challenge this notion, but rather ensures that only the actual capital invested in the enterprise over the period for which the return is calculated is reflected. AG Ex. 4.0 at 2:33-38.

In response to ComEd's claims that Mr. Effron's approach would produce a "mismatch" when calculating ComEd's earned ROE, and that this approach would artificially inflate the earned ROE (ComEd Init. Br. at 14), CCI note that AG witness Effron demonstrated that a mismatch only occurs under ComEd's methodology. Using year-end rate base tends to artificially *deflate* the calculated earned ROE, aver CCI. CCI state that Mr. Effron demonstrated that Ms. Brinkman's reasoning is wholly circular: the only reason that the earned ROE is "artificially inflated" in her example is that it is compared to the ROE calculated using a year-end rate base. AG Ex. 4.0 at 3:47-48. CCI contend that the calculation of the participating utility's returns for purposes of the ROE collar calculation should reflect the actual capital invested in the enterprise over the period for which the return is calculated. *Id.* at 2:36-38. The best measurement of ComEd's actual costs is its average rate base, say CCI, because it best represents the capital deployed to earn income over the course of the year. *Id.* at 3:48-50. This is precisely what the Commission previously concluded – prior to the 2013 amendments to EIMA – regarding the calculation of ComEd's revenue requirement and the ROE collar. *See, e.g.,* Docket No. 12-0321, Order of December 19, 2012 at 4, Schedule FR A-3. CCI maintain that this determination should not be altered because the amendments to EIMA did not change Section 16-108.5(c)(5), and thus the Commission's previous fact and statute based determinations regarding the ROE collar calculation remain intact.

CCI point out that ComEd did not present any evidence refuting Mr. Effron's conclusion that "[w]hen rate base increases over the course of the year, the use of a year-end rate base tends to artificially deflate the calculated earned ROE relative to the ROE actually earned." AG Ex. 4.0 at 8:170-173. ComEd attempted to undermine the use of average rate base in calculating the ROE collar adjustment by showing a similarity between the dollar value of the adjustment to that from use of average rate base for the reconciliation balance. ComEd Ex. 4.0 at 4:67-74. CCI aver that this results-driven illustration simply attempts to justify ComEd's preferred calculation by comparing it -- with no statutory basis -- to the measurement of the reconciliation balance under EIMA. CCI state that the very specific and limited PA 98-15 revisions to EIMA do not require use of year-end rate base for purposes of the ROE collar adjustment, and no such change is necessary to effectuate the objectives of EIMA.

CCI further note that ComEd does not argue that the year-end rate base is an accurate measure of the investment it dedicated to providing service, only that (in its view) the specification of a year-end rate base for purposes of determining the reconciliation balance is required by PA 98-15. *See* ComEd Init. Br. at 12-14. The latter distinct process is not defined by a provision amended by PA 98-15. CCI state that there is no dispute that the reconciliation process addresses only revenue requirements, with no consideration of the actual amounts ComEd collects. That function is left to the ROE collar calculations. The ROE collar has a different focus than the calculation of the reconciliation balance. CCI maintain that, regardless of the size or accuracy of ComEd's statutorily computed revenue requirement, the ROE collar looks only at the ratio of ComEd's actual earnings to its equity investment -- a calculation that does not implicate the year-end rate base specification of PA 98-15.

CCI argue that ComEd cannot use the Commission's approval of ComEd's calculations in its Docket No. 13-0386 filing as a defense to reversing the Commission's previous findings regarding the calculation of the ROE collar. CCI point out that the Commission initiated this docket with the express intent of reviewing certain aspects of the tariff filing made in that docket and to determine whether ComEd's May 30, 2013 tariff filing is in compliance with the law. CCI note that the Commission's Initiating Order notes the Commission's authority to "rescind, alter or amend its order in Docket No. 13-0386," pursuant to Section 10-113(a) of the PUA.

With respect to Staff's position, CCI argue that, in accepting ComEd's approach using year-end rate base in the ROE collar adjustment, Staff's main argument is simply that year-end is the only one specifically mentioned in other parts of the statute. CCI aver that this reasoning is an insufficient basis on which to reverse a previous Commission determination to use average rate base for purposes of this calculation. The Commission is capable and willing (having already done so) to determine the rate base that is consistent with its Article IX duties and standards to produce just and reasonable rates that recover ComEd's actual costs. The collar calculation is the only assessment of whether the amount ComEd collected equaled (within the statutorily allowed variance) its actual costs.

CCI conclude that if ComEd's changes to the calculation of the ROE collar from average rate base to year-end rate base are left unaltered, ComEd will collect revenues that do not reflect the Company's actual costs, resulting in rates that are not just and reasonable under Sections 9-

101 and 16-108.5(c) of the PUA. Because the amendments to EIMA did not require use of year-end rate base for purposes of the ROE collar calculation, and because nothing has altered prior Commission practice regarding use of average rate base in calculating the ROE collar, CCI recommend that the Commission adopt the recommendation of AG witness Effron to revise ComEd schedule FR A-1 to comport with the law and the evidence in this proceeding by using average rate base in the calculation of the ROE collar adjustment.

COMMISSION ANALYSIS AND CONCLUSIONS

The EIMA statute is silent with regard to the specific rate base measurement to use for purposes of the return on equity collar adjustment. While the amendments to EIMA prescribe that participating utilities' capital structure should be calculated using year-end rate base, those amendments did not include a requirement to use year-end capital structure for purposes of measuring the ROE collar adjustment. 220 ILCS 5/16-108.5(c)(2). The revenue requirement determination provisions of the statute are distinct from the ROE collar's assessment of the actual amounts ComEd has collected from ratepayers, which is unique among the provisions of the statute. Accordingly, in the absence of any language tying the revenue requirement determination or reconciliation with the earnings assessment (and given the distinct nature of the tasks) a specification for one task is not automatically applicable to the other task. The statutory amendments in PA 98-15 were specific to identified subsections of the statute and included nothing purporting to alter the Commission's previous determination that an average rate base best captures ComEd's actual, prudent, and reasonable costs, the focus of the formula rate statute. The Commission therefore must determine, on this record and with due consideration of this Commission's prior determination, the appropriate capital structure measurement for the ROE collar adjustment to determine and recover ComEd's actual costs.

In Docket No. 11-0721, the Commission approved use of average rate base for the purpose of measuring the ROE collar adjustment. *See* ICC Docket No. 11-0721, Schedule FR A-3. P.A. 98-0015 does not reverse that order. In addition, the evidence in this record confirms the Commission prior empirical determination -- that the average rate base for the year should be used in the calculation of the earned ROE for the purpose of the collar calculation. The net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year. To be consistent in the variable used to compute ComEd's ROE (for comparison to the collar limits), the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year. In times when the common equity balance is growing, using the end of period balance of common equity will understate the actual ROE earned on common equity provided by investors over the course of the year, and in times when the common equity balance is decreasing, using the end of period balance of common equity will overstate the actual ROE earned on common equity provided by investors over the course of a year. An inaccurate determination makes the collar a meaningless check on the operation of the formula rate process. Accordingly, the Commission adopts the record-supported recommendation of AG witness Effron to revise ComEd schedule FR A-1 to comport with the law and the evidence in this proceeding by using average rate base in the calculation of the ROE collar adjustment.

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?

CCI Position

CCI aver that ComEd has incorrectly calculated the reconciliation balance on which its interest calculation should be based, causing the calculation of the interest on that balance to be inflated by over 40%. CCI Ex. 1.1 at 7:118-128. Although the reconciliation balance is positive (meaning ComEd's initial rates recovered less than its 2012 actual revenue requirement), CCI state that ComEd did not actually have to finance that entire difference, and that (because of the tax effects of the under-recovery) the deficiency ComEd actually carried was not equal to the entire reconciliation balance ComEd calculates. Because ComEd's costs were higher than the level reflected in rates, ComEd was permitted to take higher tax deductions and pay lower income taxes than if the reconciliation balance were zero or negative. CCI Ex. 1.2 at 7:101-102. CCI note that ComEd's actual net cash investment is the difference between the projected and actual revenue requirement, less the reduction in income taxes. *Id.* at 7:102-104. CCI argue that ComEd's proposed balance for the interest calculation should be reduced by \$59 million. ComEd Ex.1.03, Sch FR A-4,(Ln 1e X Sch FR C-4, Ln 4), (\$142,394,000 X 41.175%).

CCI witness Mr. Gorman provided an illustrative calculation to demonstrate how ComEd's net cash investment could be less than the total difference between the awarded and actual revenue requirements. CCI Ex. 1.1 at 6-7:99-114. If ComEd incurred \$100,000 more in payroll expense during 2012 than was reflected in the revenue requirement awarded for 2012, the Company would have a \$100,000 higher reconciliation balance. *Id.* However, ComEd would deduct the entirety of the higher payroll expense from its income for purposes of its 2012 income taxes. *Id.* As a result, assuming a 41% tax rate, ComEd would realize \$41,000 of reduced income taxes associated with the higher payroll expense (\$100,000 X 41%). *Id.* Therefore, ComEd would only have carried a cash reconciliation balance amount of \$59,000 for the additional payroll expense (\$100,000 - \$41,000). *Id.*

ComEd's actual cost of carrying the unrecovered payroll in this illustration is based on its out-of-pocket net cash investment (cash expenditures less income taxes reduction) of \$59,000 through the period the full accounting balance (\$100,000) is recovered. As such, ComEd should only be allowed to recover carrying costs on its out-of-pocket net cash investment of \$59,000. ComEd would be made whole for the delayed recovery of the \$100,000 reconciliation accounting balance by full recovery of the net investment required, and the carrying charges on that amount (\$59,000) during the recovery period).

CCI contend that the tax savings described mean that ComEd's out-of-pocket cash position is not the total reconciliation balance, but rather the net of tax reconciliation balance. CCI Ex. 1.1 at 7:118-120. CCI argue that ComEd should not receive interest on any more than its actual net cash investment, which is the difference between the reconciliation accounting balance and the reduction in its income tax liability. CCI state that calculating interest on only the amount of ComEd's net cash investment reduces the Company's reconciliation interest by \$12.6 million. *Id.* at 8:142-143.

CCI aver that ComEd is incorrect in denying that it receives any tax or cash benefit prior to collecting the reconciliation balance from ratepayers. ComEd Ex. 1.0 Corr. at 8:146-148. CCI state that ComEd's accounting for these tax effects confirms the reality of the reduced need for financing. CCI state that, in accordance with Generally Accepted Accounting Principles ("GAAP"), the Company recorded an increase in revenue in 2012 as a result of the expected future recovery of the reconciliation balance. CCI Ex. 2.0 at 3:45-47. Further, say CCI, the Company recorded a deferred income tax expense associated with the revenue recognition. *Id.* at 3:50-52. ComEd's delayed tax payment is reflected on ComEd's books in the form of an accumulated deferred income tax ("ADIT") balance, note CCI. *Id.* at 4:65-73. This allowed ComEd to realize increased earnings in 2012. *Id.* at 3:47-48. The net impact is that the Company recorded higher earnings (due to the reconciliation revenue), but delayed payment of income tax associated with the reconciliation revenue until it is actually recovered from ratepayers in 2014. *Id.* at 3:52-55.

Because ComEd does not incur the actual tax payment associated with the reconciliation revenue until it is actually recovered, the out-of-pocket cost to ComEd is the after-tax reconciliation revenue requirement. *Id.* at 3-4:56-62. CCI state that ComEd delays the income tax payments on the revenue requirement until it is actually recovered from ratepayers. Further, the Company received a cash benefit as a result of the increased tax deductions (and thus lower taxes paid) as a result of incurring greater expenses in 2012 than were anticipated. Thus, say CCI, there were both tax and cash benefits to ComEd resulting from the positive reconciliation balance.

While ComEd frames its argument differently, focusing only on ADIT, CCI aver that only the terms (not the tax effect) are different. ComEd alleges that if it recovers only its net-of-ADIT investment in the reconciliation balance, it will not fully recover its investment. In her direct testimony, Ms. Brinkman provides two examples attempting to show ComEd's deficit. ComEd Ex. 1.0 Corr. at 27-28:543-558. CCI contend that the fatal flaw of both examples is that they do not acknowledge the tax deductibility of the interest expense recovered from ratepayers, which was discussed above. CCI Ex. 2.0 at 7:142-143. That is, say CCI, Ms. Brinkman incorrectly assumes that the carrying charge does not have an offsetting deduction for interest expense. *Id.* at 8:168-169. CCI witness Mr. Gorman corrected Ms. Brinkman's examples to reflect that tax effect. In both examples, once the deductible interest expense is reflected, ComEd is actually left with the same after-tax revenue requirement. *Id.* at 7:165-167. Though she had an opportunity in surrebuttal testimony, Ms. Brinkman did not rebut Mr. Gorman's corrections to her example or the resulting conclusion.

Mr. Gorman examined the issue from a perspective similar to ComEd's, to refute ComEd's claim that the utility receives no tax or cash benefit prior to collecting the reconciliation balance from ratepayers. Mr. Gorman noted that the Company in fact benefitted from recording deferred income tax expense because it was able to defer the payment of income taxes while it awaits recovery of reconciliation balances. AG Ex. 1.0 Rev. at 10:216-219. That is because the reconciliation revenues recorded, but not yet recovered, are not currently recognized for income tax purposes. *Id.* at 10:219-222. That deferral reduces the amount of capital investment the Company must make to support the reconciliation revenue requirement -

which has not yet been recovered. *Id.* at 10:213-216. The AG’s expert Mr. Brosch recommends, like Mr. Gorman, that the interest on the reconciliation balance should be recorded only on ComEd’s net-of-tax incremental capital investment. *Id.* at 10:225-228.

CCI note that AG witness Mr. Brosch had raised concerns about the issue of the reconciliation balance that is allowed to earn interest in ICC Docket 11-0721. *Id.* at 10-11:232-240. At that time, the Commission did not make a definitive ruling, citing concerns about the completeness of the record. ICC Docket No. 11-0721, Final Order (May 29, 2012) at 167. Mr. Brosch also raised the issue in ICC Docket Nos. 12-0001 and 12-0293, Ameren Illinois Company’s initial formula rate setting docket and its first reconciliation, but the net-of-tax concern was not addressed in the Commission’s analysis and conclusions in those orders. AG Ex. 1.0 Rev. at 11:237-240. CCI argue that in this case, Mr. Brosch and Mr. Gorman have provided ample evidence to support recovery of interest only on ComEd’s actual net cash investment. The Commission would be well within its authority to reconsider the issue based on this record, which contains compelling evidence that only a net-of-tax reconciliation balance is appropriate, say CCI.

CCI point out that AG witness Brosch testified that ComEd’s books in 2012 show an ADIT liability of \$34.077 million for federal income taxes and \$10.22 million for state income taxes (a total of \$44.3 million), comprised of expected delayed payment of income taxes due to the delayed recovery of ComEd’s under-collection in 2012, demonstrating the magnitude of the impact of the effect of tax savings on the reconciliation balance (again presented using an ADIT perspective and terminology). AG Ex. 1.0 Rev. at 12:255-265. CCI note that those ADIT balances are recorded in compliance with GAAP, under which full and complete accounting for income taxes must recognize that filing tax returns and paying income taxes will impact expenses payable in more than one accounting period. *Id.* at 12:266-270. CCI aver that the delayed collection of reconciliation revenues in 2012 created a “taxable temporary difference” under Accounting Standards Codification 740-10-30-5. *Id.* at 13:297-298.

CCI maintain that the income tax deferrals ComEd admits it recorded as a result of under-recovering its costs in 2012 will not be reflected elsewhere if the Commission does not accept Mr. Gorman’s adjustment. Even though the identified ADIT tax deferrals arise entirely from the delivery service formula ratemaking process, CCI aver ComEd has allocated them as “Non DST” and includes none of the \$44.3 million ADIT balance in rate base. In doing so, say CCI, ComEd ensures that all of the income tax deferral benefit is kept for the sole benefit of its shareholders.

CCI point to ComEd’s argument that “The formula template defines how the reconciliation interest is calculated and how tax effects are determined and calculated. It does not provide for ‘netting’ accumulated deferred income taxes (‘ADIT’) with the reconciliation adjustment within this calculation.” ComEd Ex. 1.0 Corr. at 22:440-443. CCI argue that it is telling that ComEd must rely on what it calls the formula – actually calculation sheets that underlie amounts that are the subject of this investigation – rather than what the statute requires. CCI note ComEd’s statement that the CCI and AG proposal to allow ComEd to recover interest on only its actual cash investment in the reconciliation balance (*i.e.* the net-of-tax balance) “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." ComEd Init. Br. at 17. CCI argue, that ComEd is relying on its own unauthorized modifications to "the formula" made in Docket No. 13-0386 – changes that are explicitly under investigation in this docket – rather than what is required by the Act. CCI state that the language of the Formula Rate Law does not prescribe how the reconciliation balance (on which interest is calculated) should be determined. That determination must be made by the Commission, on the basis of the provisions of the PUA, including the Formula Rate Law. CCI argue that the fact that the Commission has undertaken that specific task in this proceeding contradicts ComEd's assumption or argument that the issue is settled.

CCI note that the Formula Rate Law does not even use the term "reconciliation balance", much less does it read: "The utility shall recover its gross reconciliation balance, plus interest." If that is what the legislature intended, it could have said that. Instead, say CCI, the legislature did not address whether the reconciliation balance should be gross or net-of-tax. CCI aver that it is up to the Commission, then, to determine -- based on the over-arching "actual cost" recovery objective of formula rates -- the specific calculations of over- and under-collections and related interest amounts, within the framework of the Act.

CCI aver that the legislature has demonstrated that it can use very specific language when it intends to displace the Commission's ratemaking determinations. For example, with respect to the interest rate to be calculated on the reconciliation balance, the Act requires: "...interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior year..." 220 ILCS 5/16-108.5(d)(1). Another example CCI point out is the requirement that the Company shall earn an "investment return at a rate equal to the utility's weighted average cost of long-term debt, on the pension assets..." 220 ILCS 5/16-108.5(c)(4)(D). CCI state that such specificity does not exist on this issue. CCI argue that the fact that the term "reconciliation balance" does not even appear in the statute, much less with specific directions to calculate interest on a "gross" balance, requires that the Commission determine the appropriate methodology for that calculation.

CCI argue that Staff's only articulated grounds for rejecting the proposal of Mr. Gorman and Mr. Brosch are its flawed interpretation of the statute. In addition, CCI note that Staff's position in this case stands in contrast to its position in the Rehearing of ComEd's initial formula rate setting docket, ICC Docket No. 11-0721. In that case, Staff's position was that the interest rate should be calculated on a net of tax basis. ICC Docket No. 11-0721, Final Order on Reh'g (Oct. 3, 2012) at 28. CCI conclude that Staff's position, taken on the merits of the adjustment, was correct in that case and that Staff's legal interpretation of the statute in the instant case is not.

CCI thus recommend that the Commission accept the proposals of Mr. Gorman and Mr. Brosch to calculate interest only on ComEd's net-of-tax reconciliation balance.

COMMISSION ANALYSIS AND CONCLUSIONS

The Commission has a duty to implement the reconciliation provisions of the formula Rate Law, making such interpretations of the statute and rate making determinations as are necessary to that task. One such determination is how to calculate the reconciliation balance on which the statutory interest will be applied. As all parties agree, the statute does not explicitly define the calculation of that reconciliation amount. The legislature did not address the appropriate reconciliation balance to be used in calculating the interest that ComEd will recover. It is up to the Commission, then, to determine the specific calculation of the over- and under-collection balances on which interest is calculated, so that ComEd's actual, prudent, and reasonable costs are the basis for its rates.

ComEd and Staff maintain that the entire difference between projected and actual revenue requirements should have interest applied. The remaining parties in this case argue that ComEd should apply and collect interest only on amounts on which it incurs a carrying cost during the collection period. In particular, those parties have identified and quantified tax effects that reduce the amount on for which ComEd will actually have to incur carrying costs.

The Commission agrees that interest should be calculated only on the net-of-tax reconciliation balance. That balance represents the actual cash investment amount ComEd must carry, and it would be inappropriate for ComEd to collect interest on any greater amount when the formula rate statute requires for the determination and recovery of ComEd's actual costs. The evidence provided by CCI and the AG demonstrate that interest expense on the reconciliation balance is tax deductible. ComEd has received a cash benefit in the form of deferral of otherwise-payable income taxes. The Commission has long recognized the cash benefit of ADIT to utilities, which is why it regularly reduces utilities' rate bases for the effect of ADIT. The ADIT at issue here has a similar effect on ComEd's actual costs and must likewise be taken into account in determining ComEd's actual costs, including at this reconciliation stage of the formula rate process. We therefore adopt the adjustment of CCI and require ComEd to calculate interest only on the net-of-tax reconciliation balance.

VII. CONCLUSION

WHEREFORE, CCI respectfully request that the Commission adopt the Commission Analyses and Conclusions contained in this Draft Order.

Dated: November 8, 2013

Respectfully Submitted,

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