

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

**BRIEF ON EXCEPTIONS OF
COMMONWEALTH EDISON COMPANY**

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Commonwealth Edison Company (“ComEd”), submits this Brief on Exceptions (“BOE”) pursuant to Section 10-111 of the Public Utilities Act (the “PUA”), 220 ILCS 5/10-111, 83 Ill. Admin. Code § 200.830, and the order of the Administrative Law Judges (“ALJs”). This BOE includes proposed replacement language as authorized by 83 Ill. Admin. Code § 200.830(b)(1).

I. INTRODUCTION

The Energy Infrastructure Modernization Act (“EIMA”)¹ promises extensive benefits to customers and aims to provide utilities the full cost recovery required to deliver those benefits. That relationship between benefits, on the one hand, and investment and cost recovery, on the other, permeates EIMA and is inherent in its structure. This relationship is also clearly stated, early on, in the assurance that “a participating utility shall recover the expenditures made under the infrastructure investment program through the ratemaking process” 220 ILCS 5/16-108.5(b).

The General Assembly recently enacted Public Act 98-0015, which voided portions of prior Commission decisions and required that rate formulae be revised in several respects to

¹ Illinois Public Act (“PA”) 97-0616, as amended and supplemented by PA 97-0646 and PA 98-0015.

realize the intended full cost recovery. It also required the Commission to open a proceeding and to approve a rate formula that complied with PA 98-0015. ComEd filed its proposed rate formula, and broadly circulated it among stakeholders. The Commission, after reviewing ComEd's filing and a formal Staff report on it, held that the formula satisfied PA 98-0015 and specifically approved the resulting revenue requirements. *Commonwealth Edison Co.*, ICC Docket No. 13-0386 (Order, June 5, 2013) ("*13-0386 Order*").

The ALJs' Proposed Order ("PO") correctly concludes that ComEd's rate formula generally complies with EIMA as amended by PA 98-0015. In particular:

- The Proposed Order finds EIMA's Return on Equity ("ROE") Collar is to be calculated using year-end rate base as reflected in ComEd's FERC Form 1 reports. The PO rejects the "proposal to use an average rate base rather than a year-end rate base in calculating the ROE Collar adjustment." PO at 29-30. As the ALJs note, no other method of measuring rate base is specified by PA 98-0015 and using an average rate base would be "inconsistent with and contrary to EIMA." PO at 29.
- The Proposed Order finds that reconciliation interest applies to the full reconciliation balance, again in accordance with ComEd's Commission-approved rate formula. It recognizes that the law "requires that any reconciliation over or under collection be refunded or recovered with interest," and that "there is no language in Section 16-108.5(d)(1) of EIMA providing for ADIT to reduce the reconciliation balance." PO at 43. There is no valid reason to subtract ADIT from this balance. ComEd Init. Br. at 16-20; ComEd Reply Br. at 13-17. Doing so leads to unfair results, as most clearly illustrated by the hypothetical circumstance where customers are owed a refund but are only paid interest on a fraction of what they are due. Brinkman, Tr. 61:20 – 62:7.

The Proposed Order, however, errs when it finds that ComEd cannot recover its full cost of financing reconciliation balances (or refund that full amount to customers if the balance is positive). The PO excludes the tax cost inherent in financing anything with the mix of equity and debt referred to as the "weighted average cost of capital" or "WACC." The PO emphasizes that PA 98-0015 does not mention adding taxes, but neither does the PUA mention adding taxes in calculating a return on rate base, and taxes have been a recognized cost of WACC-based asset financing for decades. The General Assembly directed that a rate formula – and specifically an

interest calculation – be defined “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.”² By ignoring taxes, the Proposed Order contradicts this plain direction. Moreover, the law requires expressly that the reconciliation interest “be *calculated at a rate equal to*” ComEd’s weighted average cost of capital. 220 ILCS 5/16-105.8(d)(1); *see also* 220 ILCS 5/16-108.5(k)(2) and (3). The only way interest income can equal WACC financing costs is if taxes are included; that is why a *calculation* is required. ComEd’s current Commission-approved rates recognize those tax costs, whether the balance is collected or refunded.

The PO provides no reason to upset the *13-0386 Order* in this respect. Since the *13-0386 Order*, there has been no change in the relevant facts and no change in the law. Staff reviewed ComEd’s formula and issued a formal report concluding that it was “consistent with the provisions of Public Act 98-15.”³ Other stakeholders, too, did not object to any part of the formula, did not seek to intervene, did not seek rehearing, and did not appeal. While an investigation is the *procedurally* proper vehicle to consider revising a rate formula, “[i]n the absence of any change in circumstance,” a Commission order reversing a recent decision has been held arbitrary and capricious.⁴ The record here supports no reversal of direction, especially as the result would exclude the real cost of any financing that includes equity.

² Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3, specifically adopted in PA 98-0015, Section 1.

³ ICC Docket No. 13-0386, Financial Analysis Division Staff Report (May 30, 2013) at 4; Brinkman Dir., ComEd Ex. 1.0 CORR., 5:100 – 6:111.

⁴ *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 (1951) (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. COMED'S CALCULATION OF THE INTEREST RATE APPLICABLE TO RECONCILIATION BALANCES IS CORRECT AND CONSISTENT WITH THE PUBLIC UTILITIES ACT

The Proposed Order should be revised to recognize the after-tax real cost of the equity component of WACC and to include that cost in calculating the interest rate equal to ComEd's WACC, as the Commission's *13-0386 Order* does. To do otherwise would be reversible error.

A. The Plain Language of the PUA Allows ComEd to Recover its Actual Costs, Including Associated Income Tax Costs Related to the Calculation of Interest

Section 16-108.5(d)(1) of the PUA 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," as the Proposed Order states. PO at 18; *see also* 220 ILCS 5/16-108.5(d)(1). The Proposed Order acknowledges that PA 98-0015 directs utilities and the Commission to "calculate" the interest rate that when applied to the reconciliation balance equals WACC, or the weighted average cost of the utility's capital structure used to finance that balance. The PO wrongly interprets this provision to bar consideration of tax costs in the calculation.

The Proposed Order error occurs at the start. It concludes that PA 98-0015 "does not provide for adjusting WACC for the purported impact of income taxes" and that "no gross-up was provided for in the Act." PO at 18. Under the PO's view, if the average of the debt and equity cost is X%/year, then the statute means the interest rate is X%/year.

In fact, both the express literal language and contextual meaning of the phrase refute this interpretation. Interest income⁵ to ComEd can only be "equal to" the weighted average cost of

⁵ The record reflects an effort by some parties throughout this case to confuse interest income to ComEd with interest expense (which is but one part of the cost of financing that goes into the WACC). *See, e.g.*, Brinkman Sur., ComEd Ex. 4.0, 11:222 – 12:242; Brosch Reb., AG Ex. 3.0, 2:42 – 3:60. They are not the same thing, and the PO avoids this trap.

financing the reconciliation balance with a mix of both debt and equity if the actual cost of equity is used. As the Commission has universally recognized, equity finance brings with it a real tax cost.⁶ That fact was recognized in the words the General Assembly used when it directed that the interest rate be “calculated” at a rate which is equal to ComEd’s WACC. If the law had simply meant to use the same number – *i.e.*, to assume wrongly that an X% interest rate was equal to an X% WACC, when it is not – there would be no calculation to make and no reason at all for requiring one. But, the General Assembly did not direct the Commission to simply use the same number, it directed the Commission to calculate the interest rate that would equal the WACC; that calculation cannot be accurately performed by ignoring taxes.

Intervenors try to analogize EIMA reconciliation to reconciliation of various riders, emphasizing the “reconciliation” factor rather than what the interest rate represents. Here, the interest rate represents the cost of financing with a mixed bag of debt and equity; WACC is a measure of that cost. The Commission has universally, in such cases, considered the tax costs of the equity. In ordinary rate cases, for example, the WACC is routinely grossed-up for tax costs even though no section of the PUA requires or expressly authorizes it. There is nothing wrong with this practice, and the law does not require that statutes spell out details such as this. *See Hill v. Relyea*, 34 Ill. 2d 552, 555 (1966) (“Absolute criteria whereby every detail necessary in the enforcement of a law is anticipated need not be established by the General Assembly.”)

Moreover, the need to include taxes when assets are financed at WACC is accepted in ratemaking even though the statutes rarely mention those taxes. The PUA does not specifically call for the recognition of income tax costs in any rate case WACC calculation, but yet the

⁶ As the record shows, taxes will need to be paid as a result of the interest income, and ComEd can only deduct interest paid on the debt portion of its capital structure. *See* Brinkman Dir., ComEd Ex. 1.0 CORR., 14:287 - 15:296; Brinkman Reb., ComEd Ex. 3.0, 10:213 – 11:229; Brinkman Sur., ComEd Ex. 4.0, 6:119-23. The Proposed Order does not argue that ComEd does not incur tax costs; instead, the Proposed Order simply concludes that ComEd should not include those costs in its calculation of interest on its reconciliation balance. *See* PO at 18.

Commission has universally considered that cost. In the context of formula rates under EIMA, no party contests that ComEd's calculation of its return on rate base should include an adjustment to account for tax effects, notwithstanding that the PUA does not specifically require it. Indeed, in Docket No. 13-0318 (ComEd's companion formula rate update case) the weighted average cost of the capital used to finance ComEd's rate base is grossed up for taxes. There can be no closer analogy than this.

To argue, on the other hand that, because PA 98-0015 does not say "including taxes," the General Assembly meant to exclude tax costs not only runs counter to the language the General Assembly used, but also defies history. The WACC applicable to rate base is the cost of the very same pool of capital that finances the reconciliation balance. The taxes flowing from the use of that capital are just as real and just as recoverable when that capital finances the reconciliation as when it finances rate base.

B. Calculating Interest Expenses to Recover Tax Costs of WACC Financing Follows the Expressed Intent of General Assembly

Excluding tax costs also disregards the clearly expressed intent of the legislature in other portions of Public Act 98-0015. PA 98-0015 opens with the direct statement that it gives binding effect to House Resolution 1157 and Senate Resolution 821, both adopted by the 97th General Assembly. *See* 220 ILCS 5/16-108.5(k). These Resolutions make clear that the purpose of requiring the reconciliation balance to be recovered or refunded "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.*

Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3 (emphasis added).

These resolutions make clear that PA 98-0015 was aimed at reinforcing the purpose of EIMA 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). They further reinforce the specific “intent of the reconciliation ... 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).

In order for ComEd to recover its financing costs, and thus be made whole in accordance with the intent of the legislature, it is necessary to include the actual tax costs associated with the equity component of WACC financing of the reconciliation balance. If, as the Proposed Order recommends, interest is not *calculated* at a utility’s WACC including the tax effects, the interest will not place ComEd in the position it would have occupied “*had the actual cost information for the applicable calendar year been available at the filing date.*” *Id.* And, similarly, if it is not so calculated when ComEd must refund a reconciliation balance, customers will be shorted.

C. **ComEd’s Position in Docket No. 11-0721 is not Relevant in This Proceeding.**

The Proposed Order refers to ComEd’s argument on Rehearing in Docket No. 11-0721. The arguments made, and decisions reached in that docket, are not relevant to this issue.

The Docket 11-0721 rehearing was litigated in response to an Order holding that interest is calculated based *on debt costs only* (raising no tax question), and there was no reconciliation balance in that case to apply the interest to. Also, PA 98-0015 was not then in effect and the position ComEd took was not made with the benefit of that law's clarifications. ComEd cannot be deemed to have waived any argument in a future docket as a result. Moreover, the *only* evidence in this docket is that the failure to mention taxes in that docket was an oversight, not a conscious decision. Fruehe Dir., ComEd Ex. 2.0, 2:42 – 4:79. There is no evidence at all to the contrary. The Commission should not conclude that ComEd's argument in the rehearing of Docket No. 11-0721 expressed any view opposing the recovery of tax costs.

What governs this case is the law, including PA 98-0015 and the Resolutions it expressly implements and enforces, the Commission's *13-0386 Order*, and the record in this case. That record shows that there has been no material change in the facts or law since that *13-0386 Order* was entered. It shows that WACC financing, because it relies on equity, has tax costs, that those costs have been universally recognized even when not expressly referenced in the law, and that the Proposed Order's recommendation leaves those tax costs unrecovered. The Proposed Order, therefore, fails to calculate an interest rate "equal to the utility's weighted average cost of capital" (220 ILCS 5/16-108.5(d)(1)) and there is no basis on which to collaterally disturb the Commission's *13-0386 Order* that followed the legislative direction.

III. PROPOSED REPLACEMENT LANGUAGE

For the foregoing reasons, the Commission Analysis and Conclusion language on page 18 of the Proposed Order should be modified as follows:

This Section of 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) ~~This Section of the Act does not~~

~~provide for adjusting WACC for the purported impact of income taxes. 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. 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 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. The Commission notes that, in the Rehearing phase of IGC 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. It does not seem that this recovery is authorized under the amended statute. Therefore, the Commission declines to adopt the Company's interpretation of the statute to gross up the interest rate. The Commission concurs with ComEd that the legislature clearly expressed that interest was intended to be set at WACC under EIMA because it "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." Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3 (emphasis added). Nor can it be disputed that 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). The Commission agrees with ComEd that calculating interest on the reconciliation balance equal to 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 initial revenue requirement been determined using the subsequently available actual cost for the applicable calendar year. The law is clear that a utility and its customers are to be made whole through the reconciliation process when charges or credits are necessary to reconcile to actual prudent and reasonable investments and costs. This can be accomplished only by taking income tax effects into account in calculating interest at a rate equal to the utility's WACC. The Commission concludes that ComEd's approved formula rate and tariffs filed on May 30, 2013, comply with the requirements of the PUA and correctly calculate the interest on its reconciliation balances.~~

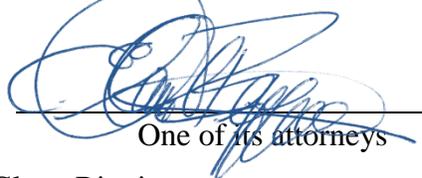
IV. CONCLUSION

ComEd respectfully requests that the Commission revise the Proposed Order in accordance with ComEd's Exceptions and, except as so revised, adopt the Proposed Order.

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Respectfully submitted,

COMMONWEALTH EDISON COMPANY

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