STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	**:**	
	:	
Proposed general increase for	**:**	**Docket No. 14-0066**
Electric service	**:**	

MidAmerican Energy Company's Reply Brief

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REPLY BRIEF
OF
MIDAMERICAN ENERGY COMPANY

NOW COMES MidAmerican Energy Company ("MidAmerican") and respectfully submits its Reply Brief pursuant to the Administrative Law Judge's Notice of Continuance of Hearing and Notice of Schedule of February 24, 2014, in the above-captioned proceeding.

I. INTRODUCTION

Overview of Requested Increase

Over the last 22 years, MidAmerican strived to keep rates stable in Illinois for customers. MidAmerican's current base electric rates are based on mid-1990's expenses and do not reflect new investments and increases in expenses. MidAmerican has presented evidence establishing that the recovery of these increases is reasonable. While Staff and MidAmerican were able to resolve many issues in this docket, a few contested issues remain.

For example, Staff continues to object to the recovery of MidAmerican's reasonable costs associated with its Performance Incentive Program ("PIP"). Staff ignores the fact that MidAmerican's PIP has been in place and has paid out awards since 1997. MidAmerican Ex. MAG 1.0, ll. 51-153. Since at least 2003, PIP payouts have been consistent and without large swings as were experienced by some companies during the recession years. Since

MidAmerican’s PIP does not have a financial target or "trigger" that must first be met, consistency is the rule rather than merely a possibility. *See* Staff Ex. 12.0, Att. B, p. 2.

Staff has inappropriately focused on details of form rather than substance in its evaluation of MidAmerican’s incentive plans. Instead, the Illinois Commerce Commission (“Commission”) should consider that MidAmerican has already removed the costs of its Long-Term Incentive Partnership Plan (“LTIP”), which is driven more by financial results, from its requested revenue requirement, consider the largely operational nature and overall effectiveness of MidAmerican’s PIP and allow its costs to be included in the revenue requirement just as it has the associated base salary expense without deduction or elimination.

In regards to Staff’s adjustment to disallow the pension asset, Staff does not dispute the evidence MidAmerican presented demonstrating that internally generated funds MidAmerican used for prepaid pension expense came out of retained earnings. Neither Staff, nor the Commission orders Staff relies on, explain how money that comes out of retained earnings can be considered ratepayer-supplied funds. As such, Staff’s recommendation is inconsistent with the law and unreasonable.

The Commission must decide this case based on the evidence in the record. 220 ILCS 5/10-103; 220 ILCS 5/10-201(e)(iv)(A). Moreover, in deciding MidAmerican’s case based on the evidence, the Commission must apply the applicable law regarding rates and cost recovery. 220 ILCS 5/10-201(e)(IV). The Commission should reject Staff’s proposals that deny MidAmerican the opportunity to recover its cost of service, whether it involves rate base adjustments and adjustments to the revenue requirements or proposals to downward adjust the recommended return on equity. Additionally, after reviewing the record evidence, the Commission should also reject Deere & Company’s (“Deere”) recommendation to reject the rate design both Staff and MidAmerican recommend. For the reasons outlined below, Staff's proposals are inconsistent with the evidence and the law, and Deere's proposal is inconsistent with the evidence and the law.

II. Test Year

MidAmerican's proposed test year of 2012, ending December 31, 2012, is uncontested. MidAmerican In. Br. at 1; Staff In. Br. at 2.

III. Rate Base

A. Overview

The attached MidAmerican Appendix A summarizes MidAmerican's Company's electric rate base. The adjusted rate base reflected on the schedule is $334,836,000. MidAmerican Appendix A at 1 and 3. As discussed below, there are two contested rate base items, the rate base adjustment related to incentive compensation and the pension asset adjustment. *See* MidAmerican In. Br. at 4-5.

B. Uncontested adjustments to MidAmerican's proposal

1. <u>Utility Plant in Service – Illinois Allocation for Change in Plant in service and accumulated depreciation</u>

MidAmerican's proposed utility plant in service, including the Illinois allocation and accumulated depreciation is uncontested. MidAmerican In. Br. at 5 and 8; Staff In. Br. at 2-3.

2. <u>Cash Working Capital</u>

This issue is uncontested. MidAmerican In. Br. at 5-7; Staff In. Br. at 3.

3. <u>Accumulated Deferred Income Tax Related to FAC</u>

This issue is uncontested. MidAmerican In. Br. at 7; Staff In. Br. at 3-4.

4. Materials and Supplies

This issue is uncontested. MidAmerican In. Br. at 7; Staff In. Br. at 4-5.

5. Fossil Fuel Inventory

This issue is uncontested. MidAmerican In. Br. at 7; Staff In. Br. at 5.

6. Original Cost Determination

This issue is uncontested. MidAmerican In. Br. at 7-8; Staff In. Br. at 5-6.

7. Planned Retirement of Generation Stations

This issue is uncontested. MidAmerican In. Br. at 8-9; Staff In. Br. at 6-9.

C. Contested Rate Base Adjustments

1. Rate Base Adjustment Related to PIP Incentive Compensation

As further discussed in Section IV, D.1 below, MidAmerican disagrees with Staff's proposal to disallow incentive compensation. MidAmerican and Staff, however, do agree with the methodology for calculating the rate base adjustment for incentive compensation and related payroll taxes and pension costs, should the Commission deny in whole or in part any of the incentive compensation. MidAmerican Ex. MJA 3.0 at 3, ll. 41-44; *see also* MidAmerican In. Br. at 10; Staff In. Br. at 9.

2. Pension Asset

MidAmerican's proposal to include prepaid pension expenses in rate base is reasonable since MidAmerican must finance the cumulative amount of pension contributions in excess of pension charges to income. This treatment is consistent with the Commission's treatment of other components of rate base, including cash working capital. MidAmerican demonstrated it financed the prepaid pension asset through the use of internally generated retained earnings. This evidence was uncontested by Staff.

Despite this evidence, Staff continues to argue that MidAmerican is simply using ratepayer funds to finance the pension asset. Moreover, Staff never adequately explains how MidAmerican customers allegedly paid for the pension asset. Instead, Staff simply argues its position is in "accordance with multiple Commission orders, in which the Commission has repeatedly held that shareholders are not entitled to a return on ratepayer-supplied funds." Staff In. Br. at 10. These orders, however, are distinguishable from this case because the facts in this case show that MidAmerican has used retained earnings to finance the cumulative amount of pension contributions in excess of pension charges to income. *See e.g.* MidAmerican Ex. RRT 2.2 demonstrating that MidAmerican has not had any equity issuances for the last ten years and financed operations with internally generated funds; MidAmerican Ex. RRT 2.0 at 9, ll. 161-169.

Staff equates "general corporate funds" to ratepayer-supplied funds and ignores the fact that the profits companies earn may be kept as retained earnings and invested back into the company, *i.e.* to finance operations and capital expenditures. Staff is incorrect by concluding that "the funds were supplied by ratepayers" because MidAmerican did "not finance or acquire funds" for the investment in the prepaid pension asset. *Id.* The record demonstrates that MidAmerican did finance the prepaid pension asset and has done so with internally generated funds from retained earnings. *See e.g.* MidAmerican Ex. RRT 2.2; MidAmerican Ex. RRT 2.0 at 9, ll. 161-169.

To further obfuscate the issue, Staff argues that MidAmerican takes issue with the "Commission's definition of ratepayer funds," but in all the Commission orders Staff cites, there is no definition of ratepayer funds or any explanation of these ratepayer funds financed the pension asset. Staff In. Br. at 13. Instead this case reflects a record where Staff has defined "ratepayer supplied funds" as "funds provided through normal operating revenues of a utility."

MidAmerican Ex. RRT 2.5. Using Staff's definition of ratepayer supplied funds, a utility is not allowed to use any retained earnings to make investments. Consequently, MidAmerican could not include a substantial amount of investment in rate base because MidAmerican has invested significant amounts in utility plant using retained earnings, or what Staff labels as "ratepayer-supplied funds." *See* MidAmerican Ex. RRT 2.5 and MidAmerican Ex. RRT 2.0 at 9, ll. 161-169. Staff, however, has inexplicitly carved out an exception for the pension asset while allowing recovery of MidAmerican's other investment in rate base.

In the cases relied upon by Staff, the Commission does not reference the use of internally generated funds created by retained earnings and why retained earnings would be considered ratepayer funds. It is illogical to conclude that the Commission considers retained earnings as ratepayer supplied funds. This conclusion contradicts the United States Supreme Court finding that "revenue paid by the customers for service belongs to the company." *See Board of Pub. Util. Comm'rs. v. New York Tel. Co.*, 271 U.S. 23, 31-32 (1926).

Staff simply ignores the established law that profits belong to shareholders. Instead, Staff is arguing that customer bill payments are similar to customer contributions in aid of construction. *See e.g..*, Staff reliance on *DuPage Utility Co. v. Illinois Commerce Comm'n*, 47 Ill. 2d 550, 554 and 558 (1971).[1] Customer payments for contributions in aid of construction are for specific projects such as a line extension and these customer contributions are used to directly reduce the carrying cost of the line extension or asset for both book and ratemaking purposes. Customer payments for utility services are not related to specific assets or costs, these payments

[1] The court holding "that the concept of plant fair value for rate-fixing purposes does not include contributions in aid of construction made by the consumers of the utility's service, since it would be unfair to require such consumers to pay rates based upon the value of a facility for which they have themselves already paid. (See also: *Preston Utilities Corp.* v. *Commerce Com.*, 39 Ill.2d 457; *Westwood Lake, Inc.* v. *Metropolitan Dade County Water and Sewer Board* (Fla.), 203 So.2d 363; *Mississippi Public Service Com.* v. *Hinds County Water Co.* (Miss.), 195 So.2d 71.)

are tied to the revenue to which the utility is entitled. *See Board of Pub. Util. Comm'rs. v. New York Tel. Co.,* 271 U.S. 23, 31-32 (1926). Contrary to Staff's contentions, MidAmerican is not "seeking to collect monies from ratepayers and then charge the ratepayers with a return on investment of those monies." Staff In. Br. at 14.

MidAmerican is only seeking to earn a return on funding to its pension plan in excess of amounts charged to income for the plan. MidAmerican's request is reasonable because it is consistent with the philosophy establishing the cash working capital component of rate base where rate base is adjusted for differences between amounts charged to jurisdictional income and cash flows related to such amounts.

As MidAmerican has previously testified and outlined in its initial brief, inclusion of the pension asset in rate base is consistent with the Federal Energy Regulatory Commission's ("FERC") recognition of the pension asset and the corresponding pension expense in rates. *See Southern Company Services, Inc*., Docket No. ER08-129-000, 122 FERC ¶ 61,218 (March 10, 2008) ("FERC Order"). MidAmerican In. Br. at 13-14. Staff tries to distinguish the FERC Order from the instant case, arguing that because the FERC order pertains to formula rates the regulatory treatment is inapplicable. Staff In. Br. at 13-14. This contention is misplaced. Regardless if rates are set by a historical test year or formula rates, the fact remains that FERC's ratemaking treatment includes the pension asset in rate base.

Moreover, for Staff to claim that FERC denied the recovery of the pension assets in rate base prior to May 2003, is misleading. Staff In. Br. at 14. In reading the FERC decision in context with its reasoning, FERC denied the recovery of the pension asset for transmission rates prior to 2003 only because the company could not establish that the pension expense reduced transmission rates prior to 2003. FERC Order at ¶ 24. As a result, FERC concluded that the company must not have financed any prepaid pensions accrued prior to May 2003. *Id.* Therefore, FERC's denial of the pension asset prior to 2003 was not related to the reasonableness of the ratemaking treatment for the pension asset, but based upon other reasons unrelated to the accounting treatment.

MidAmerican has presented sufficient evidence for the Commission to determine that the pension asset in this case was not supplied by ratepayers, but instead by shareholders. In the event the Commission rejects this evidence and determines that pension asset should be removed from rate base as proposed by Staff, then the assumed return on the pension asset must also be removed from pension expense. *See* Appendix B, FERC Order at ¶ 13.

The record in this case demonstrates that MidAmerican has prudently invested internally generated funds to ensure adequate funding of its employee pension plan. Staff fails to recognize that as a policy consideration, the Commission should encourage utilities to re-invest in their business using retained earnings. Staff's recommendation penalizes MidAmerican for making necessary investments in its utility business. Accordingly, for the reasons outlined in its initial brief and above, the Commission should allow MidAmerican's pension asset in rate base, or in the alternative, accept MidAmerican's alternative ratemaking treatment.

D. MidAmerican's Proposed Rate Base

See Appendix A and MidAmerican In. Br. 16.

IV. Revenue Requirement – Operating Revenues and Expenses

A. Overview

MidAmerican proposes a rate increase of $20,939,000 in order to recover the test year revenue deficiency. *See* MidAmerican Appendix A, MidAmerican Ex. RRT 3.1, Sch. C-1 Surrebuttal, line 15, column (g). MidAmerican In. Br. at 17. As addressed below in the contested portion of this section, Staff opposes the inclusion of MidAmerican's PIP, rate case expenses and recommends an out of test year cost relating to the state income tax rate. As previously noted, the Department of Defense ("DOD") did not file an initial brief, therefore MidAmerican cannot address issues regarding steam and distribution maintenance costs. Therefore, responses to DOD's position were addressed in MidAmerican Exs. RRT 2.0 and 3.0; Staff Exs. 3.0 and 12.0; MidAmerican In. Br. at 41-44; and Staff In. Br. at 28-30.

B. MidAmerican's Proposal

MidAmerican is proposing a rate increase of $20,939,000. As outlined below, MidAmerican's proposed revenue requirement is based on actual costs, and as such is reasonable and should be adopted by the Commission. MidAmerican In. Br. at 17-18.

C. Uncontested adjustments to MidAmerican's proposal

1. Retirement Plan

This issue is uncontested. MidAmerican In. Br. at 18; Staff In. Br. at 15.

2. Industry Dues

This issue is uncontested. MidAmerican In. Br. at 18; Staff In. Br. at 15-16.

3. Demonstration & Selling

This issue is uncontested. MidAmerican In. Br. at 19; Staff In. Br. at 16.

4. Miscellaneous & General

This issue is uncontested. MidAmerican In. Br. at 19; Staff In. Br. at 15-16.

5. Payroll Taxes Associated with LTIP

This issue is uncontested. MidAmerican In. Br. at 19, *see also* subsection 8.f. below; Staff In. Br. at 17.

6. Income Tax Adjustment

This issue is uncontested. MidAmerican In. Br. at 19-20; Staff In. Br. at 17.

7. Interest Synchronization

This issue is uncontested. MidAmerican In. Br. at 18; Staff In. Br. at 17-18.

8. Pro Forma Adjustments

These adjustments are uncontested. MidAmerican In. Br. at 20-23; Staff In. Br. at 18-19.

a. Out of Period Income Tax Adjustment

b. Depreciation on Rate Base

c. Weather Normalization

d. Coal Transportation Costs

e. Bad Debt Expense

f. Long-Term Incentive Partnership ("LTIP") Plan

g. Customer Contract Revenue

h. Transmission Delineation - 69 kV - Transmission Transfer

i. Environmental Chemical Costs

9. Rate Case Expenses

Staff supports the recovery of MidAmerican legal and travel expenses after examining the evidence presented by MidAmerican. In regards to the recovery of rate case expenses for legal and travel expenses, Staff found those costs to be just and reasonable based on the evidence. Therefore, these expenses are uncontested. MidAmerican In. Br. at 23-24; Staff In. Br. at 32.

a. *Legal Expenses*

This expense is uncontested and demonstrated to be reasonable. MidAmerican In. Br. at 18; Staff In. Br. at 24, Staff In. Br. at 32.

b. *Travel Expenses*

This expense is uncontested and demonstrated to be reasonable. MidAmerican In. Br. at 18; Staff In. Br. at 24, Staff In. Br. at 32.

D. Contested adjustments to MidAmerican's proposal

1. <u>PIP Incentive Compensation and Associated Payroll Tax and Pension Costs</u>

The Commission has allowed incentive compensation costs to be included in rates when the costs are reasonable, related to utility services and of benefit to ratepayers or utility services. *Commonwealth Edison Co.*, ICC Order Docket No. 10-0467, Order at 65 (May 24, 2011) ("Commonwealth 2011 Order"). MidAmerican has two incentive compensation plans. The Long-Term Incentive Partnership Plan ("LTIP"), an incentive compensation program with awards to senior executives and key employees triggered when after-tax net income goals are achieved, is not at issue in this proceeding because MidAmerican has removed all amounts associated with LTIP awards from the revenue requirement. MidAmerican Ex. MAG 1.0 at 10, ll. 188-201; MidAmerican Sch. C-3.12. Staff does not oppose MidAmerican's removal of LTIP expenses.

What is contested is whether incentive compensation paid under MidAmerican's other incentive compensation plan, the PIP, to rank and file non-represented employees should be included in the revenue requirement. All MidAmerican non-represented employees are eligible to receive pay under the PIP. MidAmerican Ex. MAG 1.0 at 4, ll. 49-51. These payments are made based on performance measured by achievement of goals based on the six core principles of customer service, employee commitment, financial strength, environmental respect, regulatory integrity and operational excellence. MidAmerican Exs. MAG 1.0 at 6-7, ll. 108-126; MAG 1.1, Sch. B.

Staff proposes to disallow MidAmerican's entire PIP expense of $1.119 million.[2] In its initial brief, Staff raises four objections to the PIP incentive compensation payouts, claiming that they are: (1) subjective or discretionary in nature; (2) based partially on the financial performance of the Company; (3) based on goals with no direct payout percentages assigned; and (4) based on various goals which are not associated with Illinois electric utility jurisdictional service. Staff In. Br. at 19. Because of these aspects of the PIP program, Staff argues it is not possible to determine whether implementation of the PIP results in specific dollar savings or other tangible ratepayer benefits. MidAmerican addresses each of Staff's objections below.

a. <u>MidAmerican's PIP Payouts are Reasonable Because they are Closely Tied to Sound Operational Goals</u>

MidAmerican's PIP provides incentive awards to employees based on (1) the Company's performance related to goals based on the core principles, (2) the employee's individual achievement of goals based on the core principles, and (3) the employee's performance in addressing new issues and opportunities that may arise during the year. MidAmerican Ex. MAG 1.0 at 6, ll. 102-107. Each year the Company President establishes the overall goals for the Company. The Company's annual goals are driven by its six core principles: customer service, employee commitment, financial strength, environmental respect, regulatory integrity and operational excellence. *See* MidAmerican Ex. MAG 1.2. At the end of the year the President of MidAmerican completes a review documenting the business achievements or goals

[2] Staff Ex. 12.0, Sch. 12.01; Staff IB Appendix.

accomplished for the current year for each core principle. These achievements are the basis for any adjustments to the overall incentive budget for the year. See MidAmerican Ex. MAG 2.0 at 6, ll. 110-132.

Staff does not dispute that payments under the PIP have been made since 1997. MidAmerican Ex. MAG 1.0 at 8, ll. 151-53. Since 2003, 100% of the PIP budget has been paid out in all but three years. In those years 85% or 90% was paid out, for an average payout of 96% for the period from 2003-2013. Staff Ex. 12.0, Att. B at 2. The total amount of payout has hence been stable and not determined in a subjective or discretionary manner. This stability over time is important as it is the combination of base and incentive pay that MidAmerican uses as a benchmark to determine if its overall compensation is set at competitive levels.

Staff does not appear to object to the inclusion of incentive compensation in a utility's revenue requirement, *per se*, as long as it is related to the accomplishment of operational goals. Staff In. Br. at 22. Instead, Staff objects to the process used to determine the amount to be paid out related to operational goals. *Id.* In Staff's opinion, the determination of goal achievement which underlies the payouts has been too discretionary and subjective to be reflected in the revenue requirement. *Id.* It appears that the only type of program acceptable to Staff would be one with very rigid specifically-weighted goals and metrics leading to a pre-assigned payout related to each goal and for each individual. MidAmerican is concerned that such a rigid system may not produce favorable customer outcomes when applied in a complex, changing business environment.

For example, Staff may find it acceptable if before each January a corporate goal was established to reduce the time for service calls by ten minutes and an amount of incentive compensation was established for each employee at that time for each minute of reduction.

While such a program may be clear and transparent and with linkage between the goal and the payout, it may not maximize tangible customer benefits. If the program worked as designed, employees would endeavor to meet the ten-minute objective, even if it was possible for a greater reduction to be achieved or if while meeting the time threshold, ancillary quality issues were created. If, during the year, the utility acquired a new computer system that allowed the call out time reduction of ten minutes to be met without any employee action, the plan would award the employees for no action of their own. Also, setting a goal and payout in January and rigidly evaluating it in December does not provide the flexibility to incent peak performance against changed conditions such as new regulations issued during the year or to adjust or disallow based on unintended consequences such as a widespread natural disaster that affects priorities. Moreover, if during that year, the Company experienced major flooding in its service territory, it may take more time to reach a service destination and it be necessary for service personnel to spend more time on many service calls ensuring the service is restored safely. Penalizing service employees for not meeting the goal could not only be demoralizing for the employees, but would encourage them not to spend the extra time needed for safe restoration of service.

MidAmerican's plan design does not employ rigid goals and payouts, but it is not without metrics. In 2012 MidAmerican had 39 goals that were assigned and evaluated. Furthermore, the majority of the goals were achieved. For example, Goal 18 required a 10% reduction in customer complaints, which was achieved. Goal 19 required top ten performance on customer satisfaction surveys for all customer classes. Of the 12 rankings, eight were achieved and four were not. Staff Ex. 12.0, Att. A at 11. Instead of requiring or disallowing payout, the PIP design allows the President, the person with the greatest responsibility for MidAmerican operations, to review the entire year and adjust the budgeted PIP payout amount based on the performance measured against all goals during the year. His review is not discretionary, but instead transparently tied to the six core principles instead of to rigid parameters that are subject to change during the year.

MidAmerican's longstanding history of paying incentive compensation, the PIP's reliance on six core principles focusing on operational achievements, and its undisputed achievement of tangible customer benefits should be the driving factors in allowing PIP incentive compensation.

b. The Commission's Disallowance of Incentive Compensation in *Commonwealth Edison's* Formula Rate Case is not relevant to the MidAmerican PIP

Staff relies on the Commission decision in *Commonwealth Edison Co.*, ICC Order Docket No. 13-0318, Order at 44-45 (December 18, 2013) ("Commonwealth 2013 Order") to support its proposed disallowance. Staff In. Br. at 21-22. In that case, the Commission disallowed a portion of incentive compensation expense associated with Commonwealth Edison Company's Long Term Performance Share Awards Program on the grounds that there was not clear linkage between the plan's goals and performance. There are some key differences between the incentive compensation at issue in the Commonwealth Edison decision and the proposed disallowance of expenses associated with MidAmerican's PIP.

First, at issue in the Commonwealth 2013 Order were expenses associated with the Long Term Performance Share Awards Program of Commonwealth Edison and not its Annual Incentive Program, which is the incentive program applicable to all employees. *See* Commonwealth 2010 Order at 60-61. It is appropriate for the Commission to provide a higher level of scrutiny of an incentive program that is more clearly based on financial performance and which rewards higher-level employees with more direct responsibilities for achieving financial results.

Second, the Commission's concern in the Commonwealth Edison case was not only with segregating financial and operational goals of the utility. Commonwealth's Long Term Performance Share Awards program applies to all subsidiaries of Exelon, including Commonwealth Edison Company. One of the Commission's main concerns was to avoid cross-subsidization of Commonwealth Edison Company customers by other Exelon subsidiaries. This is not the case with MidAmerican's PIP that unquestionably applies only to MidAmerican.

The decision in the Commonwealth 2013 Order is not a reliable indicator of the Commission’s position on incentive compensation plans with operational components such as MidAmerican’s PIP. In the Commonwealth case, the Commission’s disallowance of incentive compensation was applicable to a plan for highly-compensated employees instead of all salaried employees and focused on ensuring there was no cross-subsidization of utility customers by affiliates of the utility.

c. <u>There are no financial performance targets that must be met to get an award of incentive compensation under the PIP</u>

Staff’s need for clear linkage between the PIP goals and payouts is based in part on other utility plans with financial targets that must be met to receive payouts. *See* Staff In. Br. at 20, citing *Ameren Illinois and Northern Illinois Gas Company*.[3] Staff cites two goals of the PIP which it claims are based on financial performance. One goal relates to achievement of budgeted net income and cash flow and other to achievement of a level of sales margins. Staff Ex. 12.0 at 8, ll. 164-168. Staff In. Br. at 24.

These goals are not targets that must be met in order to receive incentive compensation under the PIP. In 2008, the test year for the gas rate case in which PIP compensation was

[3] *Ameren Illinois Co.*, ICC Order Docket No. 07-0585 – 07-0590 (cons.), at 106-108 (September 24, 2008), and *Northern Illinois Gas Co.*, ICC Order Docket No. 08-0363, at 28 (March 25, 2009).

included in the allowed revenue requirement, MidAmerican paid out 100% of its incentive compensation budget under the PIP even though its net income was not met. MidAmerican Ex. MAG 2.0 at 7, ll. 128-133, Staff Ex. 12.0 Att. B, at 2. In 2012, the test year in the current proceeding, neither the net income nor the sales margin goals was fully achieved, yet MidAmerican payouts at 100% of target were made under the PIP. Staff Ex. 12.0, Att. A at 19, Att. B at 2; Staff IB Appendix. Furthermore, as Ms. Grannes has testified, the PIP is paid in December, before the end of the year and before the final net income calculation is completed in January. MidAmerican Ex. MAG 1.0 at 8, ll. 133-142. While there are financial **benchmarks** among PIP goals, they are not required to be met in order to make a payout. These goals are part of the core principle of financial strength that provides tangible customer benefits by assurance of MidAmerican's long-term ability to provide reliable and cost-effective utility service.

d. Incentive compensation goals do not require direct payout percentages in order to result in tangible customer benefits

Staff's third objection to MidAmerican's PIP is with a lack of direct payout percentages that could allow a determination of the amount of incentive compensation associated with operational goals. Staff In. Br. at 19; 22-23. Most PIP goals in 2012 were operational in nature. MidAmerican Ex. MAG 3.1, Sch. A. Instead of requiring establishment of direct payout percentages, MidAmerican requests the Commission to consider the tangible customer benefits that have resulted from implementation of the PIP such as the increase in customer satisfaction, reductions in Illinois operations and maintenance expense and improvements in its employee safety as evidence that there is a relationship between overall corporate operational performance and PIP incentive compensation. MidAmerican Exs. MAG 2.0 at 8-9, ll. 167-184; MAG 2.1, Sch. A-C.

e. The allocation of PIP expenses is based on the Illinois electric jurisdiction and properly includes expenses incurred to benefit Illinois electric customers

Most of MidAmerican's PIP goals for 2012 are related to the total company. Of the 39 PIP goals for 2012, Staff contends that four[4] are not related to the Illinois electric jurisdiction.

As a multi-jurisdictional utility, MidAmerican's costs must be allocated. No issue has been raised with the jurisdictional allocations of salary expense in this case. Those few goals that single out specific states or service are related to requirements specific to that state or service and the cost of achieving those goals will be allocated to that state or service. For example, goal 17 was accomplished and is related to the Commission-ordered National Electrical Safety Code corrective action plan, a goal that was completed. These costs will be allocated as appropriate.

Moreover, the mix of state or service specific goals will vary from year to year as specific issues arise. The fact that some PIP goals in the test year were related to specific states or service is not a reason to eliminate all PIP incentive compensation expense, particularly when the method of jurisdictional allocation of costs is not subject to dispute.

f. To the extent disallowance of PIP compensation is required, the Commission should only disallow a pro rata portion associated with goals unrelated to tangible Illinois electric ratepayer benefits

Of MidAmerican's 39 PIP goals for the test period, Staff specifically objected to only six. Staff In. Br. at 24. Staff opposes two goals claimed to be based on net income or earnings, although payouts occurred when goals were not entirely met. Staff Ex. 12.0 at 7-8, ll. 163-171.

[4] At the hearing Staff witness Bridal testified that there were five separate goals not associated with Illinois public utility service. Tr.at 75, ll. 13-14. His rebuttal testimony at Staff Ex. 12.0 at 6, ll. 112-122, noted four goals considered not applicable to Illinois electric service and one gas-related goal. On brief, Staff states that number is four goals. Staff In. Br. at 24. MidAmerican assumes that the number stated in the brief is a correct description of Staff's position.

Four other goals Staff views as unrelated to Illinois electric operations. *Id.* at 6, ll. 117-122. Staff stated it has no objection to the other 33 goals of the PIP. Tr. 75, l. 21 through Tr. 76, l.2.[5]

Staff's proposed disallowance is based on the calculation of PIP payout at the Company level - the lack of a clear tie between each and every goal, and an assigned portion of incentive compensation. This argument completely overlooks evidence provided by MidAmerican that illustrates the more-specific application of goals and metrics at the individual level. *See* MidAmerican Ex. MAG 2.1, Sch. D. Staff's position discounts the uncontested evidence in the record of the benefits that MidAmerican has experienced while the PIP has been in place – the improvements in customer satisfaction, the decreases in operations and maintenance expense and the safety improvements. MidAmerican Ex. MAG 2.1, Schs. A-C.

Staff's recommendation also does not recognize that the PIP has been a key device in maintaining MidAmerican's salary expense at, and not above, market levels. MidAmerican Ex. MAG 1.0 at 4-5, ll. 58-72. If MidAmerican's PIP-related expense is not approved, the unreasonable result will be that the revenue requirement resulting from implementation of rates based on this proceeding will fall far short of including reasonable salary expense at the level which MidAmerican would require to attract and retain employees, whether via base pay or base and incentive pay. If the Commission believes that Staff's concerns must be addressed through a disallowance, a possible middle ground position respecting Staff's concerns and Company's results would be for the Commission to award a pro rata share of incentive compensation based on equal weighting of each of the 39 goals. The approach outlined in testimony of the President's overall review of performance supports such pro rata consideration of incentive compensation amounts, because the evidence shows financial goals are not "triggers" to payout and such goals

[5] MidAmerican notes that the court reporter provided MidAmerican a version transcript that contains different pagination from the transcript filed on e-docket; the page numbers are off by 5 pages. For the reply brief, MidAmerican is using the version of the transcript filed on e-docket.

have no greater weight than any other goal as evidenced by payouts from the PIP even in years when financial goals were unmet.

In other words, for each goal that the Commission agrees is not appropriately include, the Commission would disallow 1/39th of the PIP compensation. Such an approach is appropriate when no goal predominates and there is no trigger and there is a clear history of similar payments each year.

2. Steam Production

This issue is uncontested between MidAmerican and Staff. MidAmerican In. Br. at 41-43; Staff In. Br. at 25-27. In testimony, the DOD took issue with the inclusion of these costs, but DOD did not file an initial brief. For the reasons set forth in MidAmerican's and Staff's initial briefs and testimony, the DOD's recommendations presented in testimony are unreasonable and should be rejected.

3. Distribution Maintenance

This issue is uncontested between MidAmerican and Staff. MidAmerican In. Br. at 43-44; Staff In. Br. at 28-30. In testimony, the DOD took issue with the inclusion of these costs, but DOD did not file an initial brief. For the reasons set forth in MidAmerican's and Staff's initial briefs and testimony, the DOD's recommendations presented in testimony are unreasonable and should be rejected.

4. State Income Tax Rate Decrease

Staff presented an adjustment to reflect, what Staff characterizes as a known and measureable change in the Illinois corporate income tax rate, effective January 1, 2015. Staff Ex. 10.0 at 5, ll. 87-89; Staff In. Br. at 30.

Staff argues that since the tax change law was enacted during the twelve month period, the fact that the rate goes into effect outside of the twelve month period should be completely disregarded. The treatment Staff is requesting is inconsistent with the rule. Section 287.40 requires that the cost be incurred prior to the 12 months following the filing of the proposed rates. 83 Ill. Admin. Code § 287.40. This means that the effective tax rate must be incurred on or prior to December 16, 2014. The tax rate, or cost is scheduled to go into effect on January 1, 2015, which is outside of the test year window.

As MidAmerican indicated in its initial brief, if the Commission reaches out beyond this twelve month period, it is necessary for the Commission to also reach out beyond such period to quantify additional pro forma adjustments, including contractually scheduled pay rate increases for union employees, contractually scheduled escalations for coal transportation costs that begin beyond 2014, or additions to rate base to be placed in service beyond 2014 to be consistent and match all revenues with expenses. MidAmerican Ex. RRT 3.0 at 3, ll. 44-46; MidAmerican In. Br. at 45. Certainly, MidAmerican has contractual obligations that are also in effect during the test year window; however, the costs of the contractually scheduled pay raises also take effect on January 1, 2015, and thus are incurred outside of the test year window.

Staff is essentially arguing that one single cost should be included, while other "known" costs should be excluded. This treatment constitutes single issue ratemaking and does not properly match all costs with expenses during the same time period.

Moreover, Staff's proposed change is not known with any certainty. The Illinois General Assembly considered a proposal to delay the scheduled drop in the tax rate in its latest session, but that proposal was rejected. Given the current budgetary situation of the State of Illinois, it is reasonable to expect such a proposal to be raised again in the fall session and pass prior to the scheduled effective date of the rate change. MidAmerican Ex. RRT 3.0 at 3-4, ll. 37-51.

Accordingly, Staff's adjustment is improper as it violates the matching principle triggering single issue ratemaking, is contrary to the Commission's rules and is unreasonable. Therefore, the Commission should reject Staff's adjustment.

5. Rate Case Expenses

Staff continues to recommend that the Commission reject MidAmerican's rate case expenses associated with its outside witness who prepared return on equity testimony. Staff's objection, however, is not over the reasonableness of the expenses of the witness, but rather Staff objects to the way MidAmerican amended its contract with its outside witness for this case. Contrary to appellate court guidance, Staff is recommending disallowance because Staff disagrees with how the contract was amended.[6] Staff, however, agrees that the contract terms are consistent with the services performed and how much MidAmerican was charged for services, which is consistent with requirements set forth in *People ex rel. Lisa Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 101776, ¶ 13 (1st Dist. Dec. 9, 2011, *reh'g denied*, April 11, 2012) ("*Madigan*"), *appeal denied* (Ill. S. Ct. Sept. 26, 2012).

a. Rate Case Expenses for Outside Return On Equity Witness Expense are Reasonable

In its initial brief, Staff does not dispute the credentials of Dr. James Vander Weide. As noted in testimony, Dr. Vander Weide is President of Financial Strategy Associates and a Research Professor of Finance and Economics at the Fuqua School of Business of Duke University, and a respected cost of capital expert, with many scholarly publications, a

[6] *See e.g People ex rel. Lisa Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 101776, ¶ 13 (1st Dist. Dec. 9, 2011, *reh'g denied*, April 11, 2012) ("*Madigan*"), *appeal denied* (Ill. S. Ct. Sept. 26, 2012) ("we point the Commission to other cases involving an award of attorney fees, in which the party seeking attorney fees must specify (1) the services performed, (2) by whom they were performed, (3) the time expended, and (4) the hourly rate charged. *Fitzgerald v. Lake Shore Animal Hospital, Inc.*, 183 Ill. App. 3d 655, 661 (1989) (citing *Kaiser v. MEPC American Properties, Inc.*, 164 Ill. App. 3d 978, 984 (1987))."

distinguished academic career, and a wealth of experience within the utility industry. MidAmerican Ex. DAC 2.0 at 3, ll. 29-40.

Staff does not dispute that it is typical for utilities to engage an outside witness to prepare and defend testimony regarding ROE issues. Tr. at 62, ll. 9-12.[7] Staff also acknowledged that Dr. Vander Weide's work was not duplicated by MidAmerican personnel. Tr. 62, ll. 4-8.

Staff does not dispute record evidence that services for cost of capital studies, testimony, data request responses and litigation provided by Dr. Vander Weide for the Illinois case are consistent with the scope of work discussed in the engagement letter. Tr. 65, ll. 5-13. While Mr. Kahle acknowledged that the services were the same other than the fact the engagement letter referenced Iowa, the reference to Iowa is not a reason to deny the rate case expense.

Staff contends that orally amending a contract for $70,000 is not a reasonable practice, but Staff fails to offer any explanation as to why it is unreasonable in this case. Staff In. Br. at 32.

MidAmerican would agree with Staff that a new contract should have been formed or "memorialized in writing," if MidAmerican had not worked with Dr. Vander Weide for over twenty years and if MidAmerican used two different ROE witness for Iowa and Illinois. However, reducing the amendment to writing was not necessary since MidAmerican has a long-standing working relationship with Dr. Vander Weide and MidAmerican did not use a different ROE witness for its Illinois rate case.

Staff's objection to the oral amendment focuses on the fact that the Commission cannot assume that the terms of this outside witness' engagement agree with the services provided or that the cost for the outside witness services were reasonable or justified. Staff, however,

[7] MidAmerican notes that the court reporter provided MidAmerican a version transcript that contains different pagination from the transcript filed on e-docket; the page numbers are off by 5 pages. For the reply brief, MidAmerican is using the version of the transcript filed on e-docket.

established on cross examination that the very terms of the contract matched the invoices and tied to the services provided. Tr. at 64, l. 10 through 65, l. 13. Staff did not present evidence contradicting MidAmerican witness Crist's sworn testimony that he, along with MidAmerican's general counsel, approved the agreement with Dr. Vander Weide to include testimony for Illinois. If Staff found this testimony was unsupported, Staff had the opportunity to explore this theory in discovery and through cross examination. Staff, however, did not do so.

Furthermore, Staff agrees that Dr. Vander Weide provided the services in accordance with the terms and conditions of the engagement letter. Tr. at 64, l. 10 through 65, l. 13. Consequently, it is disingenuous for Staff to argue that "[t]he Commission should not accept the Company's unsupported assertion that someone at the Company orally authorized a contract amendment" when Staff did not present any evidence that contradicted Mr. Crist's assertion. Staff In. Br. at 32.

While Staff may not agree that orally amending a contract is reasonable practice, Staff cannot discount the fact that the parties in this case have a long standing working relationship and an oral amendment was all that was needed to expand the scope of work to include Illinois for the same services. In this case, Staff agreed that the terms of the agreement are consistent with the services provided and the cost of the services provided. Tr. 65, ll. 9-13.

Staff is so distracted by the mechanics of contract formation in this case, that it has lost site of the fact that Section 9-229 does not require that the Commission review include review of a specific contract to make its determination. In the *Madigan* case, the court found:

> While we make no finding as to the amount of attorney and expert fees requested, we point the Commission to other cases involving an award of attorney fees, in which the party seeking attorney fees must specify (1) the services performed, (2) by whom they were performed, (3) the time expended, and (4) the hourly rate charged. *Fitzgerald v. Lake Shore Animal Hospital, Inc.*, 183 Ill. App. 3d 655,

661 (1989) (citing *Kaiser v. MEPC American Properties, Inc.*, 164 Ill. App. 3d 978, 984 (1987)).

> "Once presented with these facts, the trial court should consider a variety of additional factors such as the skill and standing of the attorneys, the nature of the case, the novelty and/or difficulty of the issues and work involved, the importance of the matter, the degree of responsibility required, the usual and customary charges for comparable services, the benefit to the client [citation], and whether there is a reasonable connection between the fees and the amount involved in the litigation [citations]." *Kaiser*, 164 Ill. App. 3d at 984.

Similar to cases before the trial court, the Commission has the ability to consider the factors presented to establish the amount of attorney fees requested. We believe that these cases regarding an award of attorney fees can provide guidance to the Commission and the parties to comply with section 9-229.

Madigan at ¶¶51-52.

The relevance of whether an engagement letter was expanded by verbal agreement or by written agreement does not change the fact that MidAmerican presented evidence regarding the nature of the services, the time expended and the hourly rate charged. All of these factors were consistent with the engagement letter. Moreover, given the multiple rate cases in different jurisdictions, MidAmerican was able to create efficiencies by engaging the same witness to perform services for rate cases filed within the same year but in different jurisdictions.

6. Conclusion

For the reasons stated above, Staff's adjustment to remove rate case expenses for MidAmerican's technical witness is unreasonable and contrary to the record evidence. The effect of denying cost recovery would be to not allow MidAmerican to recover an appropriate and reasonable rate case expense. Consistent with the law, MidAmerican has presented evidence that (i) Dr. Vander Weide preformed services presenting ROE testimony and its associated defense during litigation; (ii) the time Dr. Vander Weide expended on the case and his hourly charge; and (iii) Dr. Vander Weide's qualifications as an ROE witness. Accordingly, there is sufficient evidence for the Commission to make a specific finding that $181,000, including $70,000 for the technical expert, of rate case expenses should be included in the revenue requirement and amortized over five years because they are just and reasonable.

V. Rate of Return

A. Overview

MidAmerican and Staff agree upon most of the components of MidAmerican's rate of return. MidAmerican In. Br. at 52; Staff In. Br. at 33. While the DOD indicated in testimony it agreed with MidAmerican's capital structure, the DOD did not file an initial brief and MidAmerican will not address the DOD's position in its reply brief. There are no issues relating to MidAmerican's proposed capital structure and cost of debt. Disagreement, however, remains regarding the authorized rate of return on common equity ("ROE").

B. Capital Structure

MidAmerican presented a capital structure consisting of 48.270% long term debt and 51.730% common equity as of September 30, 2013. MidAmerican Sch. D-1, *see also* MidAmerican Ex. RRT 1.0 at 13, ll. 262-267. The capital structure is not contested. MidAmerican In. Br. at 53; Staff In. Br. at 33-34.

C. Cost of Long Term Debt

The cost of long-term debt is not contested. MidAmerican In. Br. at 54; Staff In. Br. at 34.

D. Cost of Common Equity

The Commission has observed that "a thorough cost of common equity analysis requires both the application of financial models and the analyst's informed judgment." *In re Aqua*

Illinois, Inc., ICC Docket Nos. 05-0071, 05-0072 (Cons.), at 52-53 (November 8, 2005). *See also In re Central Ill. Pub. Serv. Co.*, ICC Docket Nos. 02-0798, 03-0008, 03-0009 (Cons.), at 83-90 (October 22, 2003). Additionally, the Commission has recognized that "[i]n determining what the cost of equity is for a utility, the Commission must base its decision on sound <u>financial principles that are used by sophisticated investors</u>. *In re Illinois Bell Tel. Co.*, ICC Docket No. 92-0448, 93-0239 (Cons.), at 103 (October 11, 1994) (Emphasis added).

MidAmerican has presented a cost of equity analysis using informed judgment that took into consideration the Commission's ratemaking principles based upon Supreme Court legal precedents[8] and impacts related to current market conditions and investor expectations. Contrary to Staff's contention that MidAmerican's analysis "contains errors" that lead to an overestimated cost of common equity, the differences between the model inputs used by MidAmerican and Staff are due to differences in opinions and not "errors." Staff In. Br. at 35.

In contrast, Staff's initial brief does not present any testimony or evidence regarding the current market conditions. Based upon the record, Staff's analysis is limited to the application of its constant discounted cash flow model ("DCF") and capital asset pricing model ("CAPM") without regard to the current economic and interest rate environment. Moreover, Staff did not provide any rationale for why an investor would not take into consideration the current market conditions as a significant factor when determining what should drive a fair return on equity for MidAmerican. Staff's recommended return on equity is undermined by these oversights in its analysis because Staff's analysis lacks consideration of the impact of current market conditions.

[8] *See i.e., the* Commission has found that the *Hope and Bluefield* cases "support the ratemaking principles applied by this Commission." *In re Consumers Ill. Water Co.,* Docket 03-0403, Order at 41 (April 13, 2004). Moreover, the Commission has observed that "Illinois law is consistent with these principles." *North Shore Gas Company and The Peoples Gas Light and Coke Company,* Docket Nos. 09-0166 and 09-0167 (Cons.), Order at 90 (January 28, 2010) ("North Shore-Peoples 2010 Order"). "And, the Commission "fully embraces the principles set forth in the *Bluefield* and *Hope* cases." North Shore-Peoples 2010 Order at 90 citing *In re Consumers Ill. Water Co.,* Docket 03-0403, Order at 41 (April 13, 2004).

Dr. Vander Weide's analysis includes both the impact of current market conditions and a broader range of investor analysis. His resulting recommendation of 10.70% is a fair return on equity and is based upon sound financial principles that are employed by investors. Therefore, the Commission should adopt MidAmerican's recommendation.

1. Including Flotation Costs Reflects Actual Market Costs and is Reasonable

Staff contends that MidAmerican's ROE recommendation is over estimated because it includes flotation costs and the Company has not established that any equity was issued during the test year. To support its contention, Staff notes that the Commission has rejected the use of flotation costs in some cases. However, the Commission's decision in this case must be based on the record evidence and not the specific facts and findings in other dockets. 220 ILCS 5-10-103; 220 ICLS 5/10-201(e)(iv)(A).

In this case, it is reasonable to adjust the recommended ROE upward and allow the recovery of floatation costs over time as opposed to recovering them immediately as Staff suggests. Dr. Vander Weide explained that he included a 5%, or 23 basis points, allowance for flotation costs. MidAmerican Ex. JHV 1.0 at 24-25, ll. 537-557. This adjustment is reasonable because it reflects the market reality that all firms that have sold securities in the capital markets have incurred some level of flotation costs, including underwriters' commissions, legal fees, printing expense, etc. *Id*. at ll. 540-541. These costs are withheld from the proceeds of the stock sale or are paid separately, and must be recovered over the life of the equity issue. *Id.* In other words, these are real costs incurred and reflect the market conditions for equity issuances regardless of the timing of the issuance. Dr. Vander Weide used a 5% allowance for flotation costs because it is a conservative estimate representing market costs.[9]

[9] The same 5% flotation cost was also considered in the use of the CAPM and Risk Premium models. MidAmerican Ex. JHV 1.0 at 29, ll. 650-651; at 35, l. 765; and at 38, ll.844-845.

Dr. Vander Weide's Appendix 3 of his direct testimony includes further discussion and explanation regarding the reasonableness of reflecting flotation costs that Staff did not address. Although Staff is correct that flotation costs are incurred only at the time a firm issues new securities, there is no reason why an issuing firm ought to recover the expense only in the current period, i.e. the test year. MidAmerican Ex. JHV 1.0 at Appendix 3-4. In fact, if assets purchased with the proceeds of a security issue produce revenues over many years, it is reasonable to recognize flotation expenses over a reasonably lengthy period of time. This recognition is consistent with the generally accepted accounting principle that the time pattern of expenses match the time pattern of revenues, and it is also consistent with the normal treatment of debt flotation expenses in both regulated and unregulated industries. *Id*.

Moreover, recovering flotation costs is consistent with the *Hope*[10] case criterion that a regulated company's revenues must be sufficient to allow the company an opportunity to recover all prudently incurred expenses, including the cost of capital. In doing so, the Commission is providing an incentive for investors to invest in the regulated company because flotation costs are an integral component of capital costs.

In short, Appendix 3 sets forth various options for the ratemaking treatment of flotation costs and the most reasonable approaches are consistent with Dr. Vander Weide's inclusion of 23 basis points to the recommended ROE. Accordingly, it is reasonable for the Commission to consider including flotation costs in MidAmerican's cost of capital in this case.

2. <u>The Use of a Larger Proxy Group Reduces the Uncertainty in the ROE Estimate</u>

Staff takes issue with Dr. Vander Weide's proxy groups used for his DCF, CAPM, and Risk Premium analysis. MidAmerican addressed the reasonableness of Dr. Vander Weide's

[10] *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) ("*Hope*")

proxy groups used for his DCF, CAPM, and Risk Premium analysis in its initial brief. *See* MidAmerican In. Br. at 56-57 and 61-63.

Staff's Sample

The Commission should recognize that Staff's recommendation is based on a small proxy group of electric utilities which creates uncertainty in Staff's recommended ROE estimate. Staff, however, ignores this basic tenet of economic theory and instead simply points to a majority of cases that either did not involve an electric utility or did not have any issues related to the proxy group selection. Staff In. Br. at 49. While there is no disputing that the Commission has relied on smaller proxy groups in past cases, the particular facts in each of those cases resulted in the use of a smaller proxy group, i.e. a natural gas proxy group is typically smaller than an electric proxy groups since there are not as many stand-alone natural gas companies. The Commission's decision in this case must be based on the record evidence and not the specific facts and findings in other dockets. 220 ILCS 5-10-103; 220 ICLS 5/10-201(e)(iv)(A).

The fact remains that Staff's screening of Dr. Vander Weide's proxy group is unwarranted. Staff's screening ignored other factors that may differentiate the risk of one electric utility from another. For example, Staff did not examine such factors as the differences in generation mix, forecasted capital expenditures; age of generation, transmission and distribution assets; customer mix; population growth and density in the service area; expenditures required to meet new environmental-related regulation; economic health of the service territory; and state laws and regulations. MidAmerican Ex. JHV 2.0 at 3, ll.48-53.

Additionally, there is no reasonable basis for Staff to eliminate electric utilities from a proxy group that are not within one notch of MidAmerican's 'A-' rating since bond rates related to the risk that a company will default on the payment of interest and principal on its bonds.

MidAmerican Ex. JHV 2.0 at 8, ll. 178-179, MidAmerican In. Br. at 56-57. Equity investors, however, are concerned with the variability in the return on their equity investment. *Id.*, ll. 180-181. Therefore, equity risk is different from bond risk and bond ratings are a poor indicator of the risk of investing in a company's equity. *Id.*, ll. 80-181. Indeed, Staff acknowledges corporate credit ratings are not a perfect measures of equity risk. Staff In. Br. at 51. Moreover, Dr. Vander Weide demonstrated that the average allowed return on equity for electric utilities is approximately the same regardless of the company's bond rating. MidAmerican Ex. JHV 3.0 at 7, ll. 126-134. This record fact undermines Staff's contention that bond ratings correlate to a company's equity risk. Staff In. Br. at 51.

Staff's data on percent regulated assets for 2012 and bond ratings do not reflect differences in the risk of investing in the equity of one utility compared to another. Consequently, the Commission should rely on MidAmerican's larger proxy group used by Dr. Vander Weide to determine MidAmerican's cost of equity.

3. Discounted Cash Flow Model

See MidAmerican In. Br. at 57-59.

4. MidAmerican's CAPM inputs are consistent with economic theory and appropriately estimate the ROE

Staff's CAPM recommendation ignores the recent extraordinary efforts of the Federal Reserve to keep interest rates low, and Staff's recommendation does not reflect MidAmerican's opportunity to earn its required return on its investment during the forward-looking period during which rates will be in effect. Instead of using forecasted treasury yield, Staff used an average yields on thirty-year U.S. Treasury bond for the month of September 2013, which failed to take into consideration the forecasted interest rates and the fact that the Federal Reserve has taken extraordinary steps to depress the interest rates in order to stimulate the economy. MidAmerican Ex. JHV 3.0, at 20, ll. 217-225.

It is a stretch to argue that current rates already reflect investors' expectations of future interest rates since the current long-term interest rates are determined by both the demand and supply curves for long-term government securities. While the demand curve for long-term government securities may or may not reflect investors' expectations of future interest rates, the supply curve primarily reflects the Federal Reserve Board's policy of keeping interest rates low in order to stimulate the economy. MidAmerican Ex. JHV 3.0 at 20, ll. 217-225. Because current interest rates reflect the influence of both the demand and supply for long-term government bonds, and the supply is largely administered by the Federal Reserve, current interest rates do not reflect or equal long-term interest rate expectations. MidAmerican Ex. JHV 3.0 at 20, ll. 217-225.

The Commission has also recognized the current market conditions and the extraordinary efforts of the Federal Reserve to set interest rates low to stimulate the economy. In Docket Nos. 07-0241 and 07-0242 (Consol.), the Commission observed "the whole point of conducting such analyses is to develop a proxy for the appropriate ROE. When it can be shown that the proxy itself strays from a zone of reasonableness to the degree where it offers an unreliable estimate of the appropriate ROE, as the Utilities have demonstrated with Staff's DCF analysis in this case, deviation from accepted practice may be warranted." *North Shore Gas Company and The Peoples Gas Light and Coke Company*, Docket Nos. 07-0241 and 07-0242 Cons., at 92 (February 5, 2008) ("North Shore-Peoples 2007 Rate Case"). While MidAmerican understands the facts are slightly different in this case, the theory still holds. Staff simply fails to recognize that a forward-looking cost of equity that will be reflected in rates is a better proxy for the risk free rate. Therefore, the forecasted rise in interest rates that is widely expected to occur in the future should be incorporated into its analysis. Reliance on a risk free rate based on the interest rates in effect in September of 2013 is hardly a reasonable proxy to estimate an ROE that will be in effect beginning late 2014.

Moreover, the Commission has recognized the need to examine the risk free rate in relation to the market conditions. In Docket No. 09-0312, the Commission found:

> MEC is correct that the rates approved by this Order will be applied on a going-forward basis. The period of time during which those rates will apply is, however, unknown[11]. Accordingly, the Commission, which cannot establish a cost of equity that fluctuates with investor expectations over time, must approve a single cost of common equity that will function effectively for an indefinite number of years. If MEC is correct that Staff's selected spot yield is anomalously low, because of transient circumstances that are already trending up toward normalcy, the Company will be disadvantaged in the capital markets in the foreseeable future. Conversely, if Staff is correct that the actual August 18, 2009 yield reasonably reflects the return that knowledgeable investors expect over the next 30 years, customers are likely to overpay for MEC's capital costs if the Company's risk-free rate is utilized.
>
> The Commission concludes that Staff's spot yield is too low to serve as the risk-free rate for CAPM purposes in this instance. Staff itself recognizes that real GDP growth "is a proxy for the real risk-free rate."[12] Ms. Freetly relies on sources predicting average annual real GDP growth of 2.6% (over 10 years) to 2.7% (over 30 years), which "imply a long-term, nominal risk-free rate between 4.3% and 5.2%."[13] She thus accepts the conceptual efficacy of forecasts and demonstrates that her chosen 4.4% rate is at the low end of the particular forecasts she cites[14]. Moreover, those forecasts are consistent with the range of 30-year bond yield

[11] Fn 90. MEC's rates were last revised in 2002. By comparison, Peoples Gas and North Shore Gas sought revisions in 2007 (Dockets 07-0241 & 07-0242 (consol.)) and again in 2009 (Dockets 09-0166 & 09-0167 (consol.)).

[12] Fn 91. Staff Ex. 6.0 at 15; *Id*. at 16 ("…both the real GDP growth rate and the real risk-free rate of return should be similar…").

[13] Fn 92. *Id*. at 15-16.

[14] Fn 93. Curiously, on exceptions, Staff criticizes the very forecasts by which Ms. Freetly validates her selection of the actual 30-year bond-yield of 4.4% (on August 18, 2009) to estimate the long-run risk-free rate. Staff BOE at 3. Yet absent those forecasts, there is no evidentiary basis for Ms. Freetly's choice of treasury bonds over other available proxies for real risk-free rates. As she states, "short and long-term inflation and real risk-free rate expectations, including those that are reflected in the yields on U.S. Treasury Bills, U.S. Treasury Bonds, and the prices of common stocks, should equal over time." Staff Ex. 6.0 at 13. Ms. Freetly selected the bond yield precisely because it "more closely approximates" the forecasted growth rates she relied upon. *Id*. at 16.

forecasts (4.8%-5.2%) that MEC presents.[15] Therefore, the Commission will select a yield of 4.8% for the CAPM risk-free rate here. That is slightly above the mid-point of Staff's acknowledged range of forecasted GDP growth and within the range of MEC's forecasted long-term bond yields. It is also virtually identical to the 4.83% long-run economic growth rate Staff used in its DCF analysis, which was derived from the same actual (August 18, 2009) 30-year Treasury bond yield (averaged with the 10-year Treasury bond yield on that date) used for CAPM purposes here.[16]

In Re: MidAmerican Energy Company, Docket No. 09-0312, at 19-20 (March 24, 2010)

In Docket Nos. 09-0166 and 09-0167 (Consol.), the Commission found that:

The record shows that during the time Staff relied on a spot quote for 30-year Treasury bonds for the risk free rate there was considerable volatility. Indeed, as Mr. Moul noted in his testimony, if Mr. McNally had selected a date just three weeks later his risk free rate would have been higher. According to the record, using a reasonable forecast of 30-year Treasury bonds with Staff's CAPM yields an ROE of 10.52%. NS-PGL Ex. PRM-2.0 (Rev.) at 24-25. Considering the unreliability of solely using spot data in this case, we find using an average of Staff's CAPM cost of equity estimate of 9.95% with Staff's CAPM including *Blue Chip* forecasts of 10.52% is a more equitable result. Thus, we accept a CAPM estimate of 10.24%.

North Shore Gas Company and The Peoples Gas Light and Coke Company, Docket Nos. 09-0166 and 09-0167 (Consol.), Order at 127 (January 28, 2010) ("North Shore-People's 2009 Rate Case").

In the Commonwealth 2011 Order, the Commission found that:

The Commission finds that if Mr. McNally's CAPM were adjusted on an average of the 2 risk –free rates and closer to the average rate throughout the year or half of the 67 basis points. The result of 33.5 points added to his CAPM model would be in the range of 10.50%. This number would be more in the range of Dr. Hadaway's midpoint of 10.6%.

Commonwealth 2011 Order at 153.

[15] Fn 94. MEC Ex. KCM 2.0 at 11-12. On exceptions, Staff erroneously asserts that this Order "adopt[s] the Blue Chip forecast of 30-year U.S. Treasury bond yields as the measure of the risk-free rate." Staff BOE at 6. In fact, we are adopting a risk-free rate derived from Staff's own analysis of GDP growth, which we note to be *consistent with* the forecasts MEC uses.

[16] FN 95 referencing Dockets 09-0166 & 09-0167 (consol.) at 124.

As explained in testimony and in the initial brief, if Staff had employed a forward looking risk free rate based on the forecasted yield on long-term Treasury Bonds of 5.17%, then Staff's CAPM analysis would have produced a cost of equity of 10.10%. Had Staff also attempted to reduce the uncertainty in its estimate, Staff would have also relied on a larger proxy group. MidAmerican Ex. JHV 2.0 at 13, ll. 262-271. If Staff used the 28 company proxy group, Staff's utility beta would have been 0.73, and using the appropriate risk free of 5.17% would have yielded a CAPM result of 10.50%. MidAmerican Ex. JHV 2.0 at 14-15, ll. 274-301. The use of a forecasted interest rate does not overstate the ROE, but instead reflects a fair rate of return that allows MidAmerican the opportunity to earn its required rate of return during the forward-looking period in which rates will be in effect.

Accordingly, the Commission should reject Staff's use of a Treasury yield based on information from September 2013 as a risk-free rate in the CAPM and accept the use of forward-looking and historical data in this case, as proposed by Dr. Vander Weide.

Weakness of the CAPM

Staff also takes issue with Dr. Vander Weide's criticism that the CAPM underestimates the cost of common equity. Staff In. Br. at 54. Staff claims that Dr. Vander Weide's explanation of how the Fama and French articles support his conclusion contains several flaws. Specifically, Staff claims that the explanation is based on: (1) a single observation from the Fama and French regression analysis; (2) market returns that represent only returns on large company stocks; (3) average realized one-year returns rather than expected returns; and (4) an average Treasury bill rate rather than an average Treasury bond rate. Staff In. Br. at 55 and Staff Ex. l5.0 at 11 – 12.

In short, Staff has mischaracterized Dr. Vander Weide's testimony and fails to recognize that the CAPM is "theoretical and has its own limitations." North Shore-People's 2009 Rate Case at 123. Dr. Vander Weide has identified these limitations and noted that these "limitations require that [the Commission] consult general financial market information to ensure that the model results presented . . . are generally consistent with real world conditions, and to guide [the Commission] determination of reasonable rates of return on equity based on the models that [the Commission] deem[s] appropriate for . . . consideration." *Id*.

a. Single Observation

As Dr. Vander Weide pointed out in testimony, Staff's criticisms of the Fama and French articles to support the conclusion that the CAPM underestimates the cost of equities for companies with betas less than 1.0 is misplaced. Although Dr. Vander Weide used a single observation from the Fama and French regression analysis in his response to Staff's data request, Staff fails to address the fact that Dr. Vander Weide's single observation has a beta value that most closely approximates the current average beta value for electric utilities and that, as a result, the observation is the most relevant one for testing whether Dr. Vander Weide's conclusion holds for electric utilities. MidAmerican Ex. JHV 3.0 at 12, ll. 251-256. Moreover, Staff also fails to recognize that the same conclusion would be reached if Dr. Vander Weide had used *any observation* with a beta value less than 1.0. *Id*. at ll. 256-258.

b. Market returns that represent only returns on large company stocks

Staff's claim that the market return in the Fama and French regression analysis only represents the returns on large company stocks is incorrect. *Id*. at ll. 259-261. The 2004 Fama and French article clearly states that the authors estimate the market return by calculating a weighted average of the market return on all New York Stock Exchange (NYSE), American

Stock Exchange (AMEX), and National Association of Securities Dealers (NASDAQ) stocks in the Center for Research in Security Prices (CRSP) database:

> The evidence that the relation between beta and average return is too flat is confirmed in time-series tests, such as Friend and Blume (1970), Black, Jensen and Scholes (1972) and Stambaugh (1982). The intercepts in time-series regressions of excess asset returns on the excess market return are positive for assets with low betas and negative for assets with high betas.
>
> Figure 2 provides an updated example of the evidence. In December of each year, we estimate a preranking beta for every NYSE (1928–2003), AMEX (1963–2003) and NASDAQ (1972–2003) stock in the CRSP (Center for Research in Security Prices of the University of Chicago) database, using two to five years (as available) of prior monthly returns. We then form ten value-weight portfolios based on these preranking betas and compute their returns for the next twelve months. We repeat this process for each year from 1928 to 2003. The result is 912 monthly returns on ten beta-sorted portfolios. Figure 2 plots each portfolio's average return against its postranking beta, estimated by regressing its monthly returns for 1928–2003 on the return on the CRSP value-weight portfolio of U.S. common stocks. [Fama and French 2004 at 32]
>
> *Id.* at ll. 261-285.

c. Average realized one-year returns rather than expected returns

Staff's claim that the Fama and French regression analysis relies on realized one-year returns is also incorrect. As noted above, the 2004 Fama and French article also clearly states that their study is based on two to five years of returns. Furthermore, Staff fails to note that virtually all published tests of the CAPM rely on realized returns because it is only realized returns that are observable. *Id.* at ll. 286-291.

d. An average Treasury bill rate rather than an average Treasury bond rate

Staff claims that the Fama French regression analysis does not apply to Staff's CAPM analysis because the Fama French regression is based on an average Treasury bill rate, whereas Staff's analysis is based on an average Treasury bond rate. However, Staff fails to recognize that the conclusion that the CAPM underestimates the cost of equity for companies with betas less than 1.0 continues to hold when long-term interest rates are used to estimate the risk-free rate component of the CAPM. *Id.* at ll. 292-295.

e. Rigorous studies of the CAPM

Finally, Staff contends that the Fama and French article was contradicted by more rigorous studies of the CAPM. Staff In. Br. at 56. Staff, however, does not provide any specific examples of the "more rigorous studies" that contradict the Fama and French results.

As Dr. Vander Weide pointed out in testimony, the CAPM has its limitations and the Commission must recognize these theoretical limitations and consult general financial market information to ensure that the model results presented are generally consistent with real world conditions. MidAmerican presented evidence that if Staff's CAPM analysis recognized these limitations, Staff's CAPM would have yielded a range of 10.10%, employing a forecasted risk-free rate, to 10.50%, employing a larger proxy group.

5. <u>Relying on the Results of the Risk Premium Models is Reasonable</u>

Staff contends that Dr. Vander Weide's Risk Premium analyses are unsuitable for use in measuring a utility's cost of common equity and that previous Commission decisions agree with this proposition. Staff In. Br. at 57. Staff's reliance on the 2009 People's order fails to highlight the two more recent People's orders where the Commission considered the company's overall recommendation, which was an average that included a Risk Premium estimated. *North Shore Gas Company and Peoples Gas Light and Coke Company*, Docket Nos. 11-0280/11-0281 (Consol.) at 139 (January 10, 2012); *North Shore Gas Company and Peoples Gas Light and Coke Company*, Docket Nos. 12-0511/12-0515 (Consol.) at 208 (June 18, 2013). Consequently, while the Commission may not endorse the use of the Risk Premium model, the Commission nevertheless has considered the estimate as part of a cost of equity recommendation; and the

Commission has not prohibited parties from considering a Risk Premium cost of equity estimate as additional support for a cost of equity recommendation in this docket. *Id*.

For the reasons outlined in MidAmerican's initial brief and recent Commission consideration of recommended ROE's using the Risk Premium models, it is reasonable for the Commission to give consideration to the results of the risk premium models presented in Dr. Vander Weide's testimony. MidAmerican In. Br. at 61-63.

6. Conclusion

As noted above, the contested issues regarding the return on equity center around the application of the models employed by the return on equity witnesses. The standard for the Commission to apply is which application considers and relies on information an investor would employ, and which application is more reasonable in light of the current market conditions and ratemaking principles employed by the Commission.

MidAmerican submits, an investor would:

- recognize no single test or model is determinative of the cost of equity, and the more perspectives considered, the more the results can be checked for reasonableness;
- recognize a risk free rate using analysts' forecasts is an objective means of estimating investor return expectations and should be an integral component of the return on equity determination for an electric utility; and
- recognize that a forward-looking cost of equity that will be reflected in rates that will not become effective until sometime in the future, should incorporate the rise in interest rates that is widely expected to occur in the risk free rate;

When the Commission evaluates the expectations of investors, it will find that Dr. Vander Weide did not over estimate MidAmerican's cost of common equity, as Staff would lead the

Commission to believe. MidAmerican has demonstrated that its recommended return on equity of 10.70% is commensurate with that of comparable risk enterprises; will maintain its financial integrity; and will allow it to attract capital on reasonable terms. *See Hope* and *Bluefield.* An allowed return on equity for MidAmerican's Illinois electric utility operations of 10.70% is reasonable and relies on market data investors would consider. The resulting recommendation including MidAmerican's flotation costs will ensure MidAmerican maintains its financial integrity, will be able to attract capital on reasonable terms and will be afforded the opportunity to earn a return commensurate with the returns available to enterprises of comparable risk.

E. Weighted Average Cost of Capital

For MidAmerican's recommended weighted average cost of capital, please see Appendix A, page 4 and MidAmerican In. Br. at 64.

VI. Riders

A. Uncontested Transmission Cost Recovery Rider

1. Overview

Rider TS is uncontested and demonstrated to be reasonable. MidAmerican In. Br. at 18; Staff In. Br. at 58-59.

2. Rider TS – Transmission Service Tariff

Rider TS is uncontested. MidAmerican In. Br. at 65-66; Staff In. Br. at 59-60.

B. Uncontested Riders Eliminated

MidAmerican proposed to eliminate several riders in its new tariff. No party objected to the elimination of these riders. MidAmerican In. Br. at 66-68; Staff In. Br. at 60.

1. Rider 3 – Commercial Electric Space Heating

The elimination of this rider is uncontested. MidAmerican In. Br. at 67.

2. Rider 4 - Interruptible Service

The elimination of this rider is uncontested. MidAmerican In. Br. at 67.

3. Rider 5 – Limited Term Contract Service

The elimination of this rider is uncontested. MidAmerican In. Br. at 67.

4. Rider No. 11 – Economic Development

The elimination of this rider is uncontested. MidAmerican In. Br. at 67-68.

5. Rider No. 13 – Municipal Compensation Adjustment

The elimination of this rider is uncontested. MidAmerican In. Br. at 68.

6. Rider No. 15 – Optional Commercial Time of Day Service

The elimination of this rider is uncontested. MidAmerican In. Br. at 68.

7. Rider No. 17 - Non-Residential Real Time Pricing

The elimination of this rider is uncontested. MidAmerican In. Br. at 68.

C. Uncontested Changes to Existing Riders

1. Energy Efficiency Cost Recovery Factor

The changes to the EECR are uncontested. MidAmerican In. Br. at 69.

2. Fuel Adjustment Clause

The changes to the FAC are uncontested. MidAmerican In. Br. at 69.

VII. Cost Allocation and Rate Design

A. Contested Issue

1. The Hourly Costing Model

Staff and MidAmerican agree on the use of the Hourly Costing Model ("HCM") to allocate generation costs. Deere, however, still contends the Commission should reject the HCM despite the fact there is not an alternative cost of service study in the record in this case. Deere In. Br. at 1-6. DOD raised similar objections in testimony, but failed to file an initial brief addressing the issue. As such, MidAmerican cannot reply to the DOD, but has addressed DOD's issues in MidAmerican Exs. CBR 2.0 and 3.0.

2. Introduction – Cost of Service Study

See MidAmerican In. Br. at 69-70.

3. HCM Overview

See MidAmerican In. Br. at 70-71.

4. Staff's Modification to the HCM is Reasonable and Addresses Concerns Raised by Deere and DOD.

Staff proposed to modify the HCM such that the energy component of the HCM reflects retail fuel costs only, as opposed to reflecting the actual value of the hourly MISO LMPs, with all non-fuel generation costs allocated to and contained within the capacity component of the HCM. MidAmerican Ex. CBR 2.0 at 3, ll. 35-39.

MidAmerican agreed with Staff's modification and agreed that the proposed change better segregates retail fuel costs from non-fuel costs in the HCM. This change allocates more costs to lower load factor customers and removes any concerns over the potential double-counting of capacity cost in the energy component of the HCM. MidAmerican Ex. CBR 2.0 at 3-4, ll. 41-46; *see also* MidAmerican In. Br. at 72.

Deere, however, continues to ignore this change and argues the HCM is "untested" and does not reflect cost causation in allocation of generation of capacity costs. Deere In. Br. at 3. Deere argues that MidAmerican does not "acquire generation capacity assets on an hourly basis; only energy, or some categories of reserves, is acquired on a real-time or hourly basis." Deere In. Br. at 3. Deere indicates that this allocation method over allocates capacity costs to high-load factor customers, and as a result, the HCM does not reflect cost causation principles. *Id.* As explained in both MidAmerican's and Staff's initial briefs, this is simply not the case. MidAmerican In. Br. at 73-77, Staff In. Br. at 62.

While capacity is not "acquired" on an hourly basis, some amount of capacity is needed to serve load in every hour of the year. By using MISO LMPs and weighted capacity costs for all hours in the year, more accurate market-based information is reflected in the HCM allocator, which in turn reflects more accurate costs to serve customers for every hour. Staff Ex. 7.0 at 11, ll. 235-239. The record demonstrates the price signals under the Modified HCM are clear, unmistakable, and accurate. Customer classes that use high amounts of energy during times of high system load (residential customers, for example) pay the price for that energy and pay relatively high average generation prices under the HCM. MidAmerican Ex. CBR 2.0 at 7, ll. 125-129. Customer classes that use little or no energy during times of high system load (lighting, for example) or that use a large amount of energy during off-peak periods as compared to on-peak periods (industrial classes, for example) enjoy favorable pricing under the HCM. *Id*. *See also* MidAmerican In. Br. at 76, chart, and MidAmerican Ex. CBR 2.0 at 7.

The HCM is a well-balanced allocation methodology that neither over-emphasizes nor under-emphasizes the allocation of energy or capacity costs to any particular customer class. Moreover, the HCM sends price signals that accurately reflect the competitive electric market.

The hourly costs are a function of MidAmerican's total system load, which results in higher costs during hours of peak demand. If the load for one customer class increases, all classes experience a higher energy and capacity cost for that hour, which closely resembles how competitive markets work – during hours of high demand, all customer classes must pay higher prices, not just particular customer classes.

Deere also complains the HCM is an "untested methodology" and does not appear to be in use in other state jurisdictions for a similar utility. Deere In. Br. at 3. Portraying the HCM as untested is a stretch. As noted in its initial brief, since the time of the hearing in the Illinois rate case, the Iowa Utilities Board ("Board"), on rehearing, upheld its decision approving the use of the HCM as a generation allocator in Iowa. *In Re: MidAmerican Energy Company*, IUB Docket No. RPU-2013-0004, Order Approving Settlement, with Modifications, and Requiring Additional Information at 79 (March 17, 2014) and Order on Rehearing (July 10, 2014). On July 31, 2014, the Board approved MidAmerican's compliance tariffs and rates established allocating generation costs using the HCM are now in effect in Iowa. *In Re: MidAmerican Energy Company*, IUB Docket Nos. TF-2014-0034 and RPU-2013-0004, Order Approving Tariff and Requiring Filings (July 31, 2014).

Deere further complains MidAmerican has not provided a more traditional alternative in the record, such as the Average and Excess method ("A&E"). Deere, however, fails to cite to any requirement in the Commission's rules where MidAmerican is required to provide an alternative cost of service study. The Commission rate case filing requirements specify a utility is required to file a cost of service study. The rules do not require multiple cost of service studies, and in MidAmerican's last rate case, the Commission did not order MidAmerican to file multiple cost of service studies.

In its direct testimony, Staff did not request that MidAmerican file an A&E cost of service study and Staff did not request an alternative cost of service study through data requests. Most notably during discovery, Deere did not request that MidAmerican either provide information needed to conduct a cost of service study using the A&E method, or request that MidAmerican conduct an A&E cost of service study and provide the study to Deere. Deere also did not request that MidAmerican provide an alternative study in either Deere's direct testimony or through a motion requesting that the ALJ require such a study. Deere seems to argue the burden was on MidAmerican to file an A&E cost of service study. Deere, however, is simply avoiding its burden of establishing either that the HCM is unreasonable or that an alternative methodology is more reasonable.

As noted above, MidAmerican complied with the Commission's rules and conducted a cost of service study. Staff indicated in direct testimony, it supported the HCM with modifications. MidAmerican adapted its cost of service study to incorporate Staff's modifications and presented the updated HCM in rebuttal testimony. It is clear that MidAmerican made its prima facie case that the HCM is a reasonable cost allocator for generation. Once MidAmerican met its burden, the burden then shifted to Deere. Deere simply failed to show that the HCM was unreasonable or offer an alternative cost of service study for the Commission to evaluate and compare in relation to the HCM.

Illinois law is clear, "once a utility makes a showing of costs necessary to provide service under its proposed rates, it has established a prima facie case, and the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith." *City of Chicago v. Commerce Commission* 133 Ill. App. 3d 435, 443 (1st Dist. 1985).[17]

[17] *See also Chicago v. Illinois Commerce Com.*, at 442, "the erroneous assumption that a utility has the burden of going forward on any and all issues which are conceivably relevant to the reasonableness of its proposed

Under Commission rules, MidAmerican is not required to provide multiple cost of service studies so Deere can pick and choose which allocates cost in a manner that benefits Deere's load shape the most. MidAmerican has not shown inefficiency or bad faith in this case. Under the Commission rules, MidAmerican is obligated to present a cost of service study that allocates the costs equitably among all customer classes. It is then up to Deere to establish either that the HCM is unreasonable or that some other methodology is preferable. For the reasons Staff and MidAmerican outlined in testimony and in briefs, Deere has simply failed to establish that the HCM unreasonably allocates generation costs.

5. Conclusion

MidAmerican's HCM as modified, and accepted by Staff is a reasonable cost of service allocation for generation. The HCM accurately reflects how MidAmerican incurs costs to serve customers. The record demonstrates that the HCM allocates costs consistent with cost causation principles, which accurately reflect the competitive wholesale market. The HCM recognizes that MISO membership has changed how MidAmerican incurs generation costs, and it accurately allocates those costs on an hourly basis. *See also* Staff In. Br. at 61. The evidence supports the reasonableness of the HCM to allocate generation costs and it should therefore be adopted by the Commission.

B. Uncontested Issues

1. Single-Phase and Three-Phase Split System Methodology

The use of the NCP is uncontested. MidAmerican In. Br. at 77-78.

(i) Transmission Cost Allocation

The use of the 12 CP methodology is uncontested. MidAmerican In. Br. at 77.

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rates … is directly contrary to the overwhelming weight of authority and would place an impossible burden on the utility of anticipating the basis of every intervenor's objection and of coming forward with evidence during its case in chief with respect to each objection."

2. Rate Design

There are no contested rate design issues. MidAmerican In. Br. at 78; Staff In. Br. at 63-65.

3. Weather Normalization

The weather normalization adjustment is uncontested. MidAmerican In. Br. at 78-79.

4. Unbundled Bill

No party took exception to the unbundling of MidAmerican's bill. MidAmerican In. Br. at 79-80.

VIII. Tariff Revisions

A. Uncontested Miscellaneous Tariff Issues

1. Tariff Reorganization

This issue is uncontested. MidAmerican In. Br. at 80-81; Staff In. Br. at 65.

2. Rate Elimination

No party opposed the elimination of two rates. MidAmerican In. Br. at 80-81.

3. Reconnection Fee

This issue is uncontested. MidAmerican In. Br. At 81; Staff In. Br. At 65-66.

4. Refunds for Billing Adjustments

This issue is uncontested. MidAmerican In. Br. at 81; Staff In. Br. at 66.

5. Changes to Definitions

This issue is uncontested. MidAmerican In. Br. at 81-82; Staff In. Br. at 66.

B. Uncontested Non-Substantive Tariff Changes

The non-substantive tariff changes are uncontested. MidAmerican In. Br. at 82.

IX. Conclusion

For the reasons set forth in MidAmerican's initial brief, as noted above and reflected in the record, MidAmerican Energy Company respectfully request that the Commission accept the uncontested positions and determine that MidAmerican's positions on the contested issues are reasonable, consistent with Illinois law, and MidAmerican's rate application, as revised, be adopted in setting final electric rates.

WHEREFORE, MidAmerican Energy Company respectfully requests that the Illinois Commerce Commission issue an Order approving MidAmerican's rate application.

DATED this 7th day of August, 2014.

Respectfully submitted,

MIDAMERICAN ENERGY COMPANY

By * /s/ Steven R. Weiss*
One of its attorneys

Steven R. Weiss
Senior Vice President & General Counsel
4299 N.W. Urbandale Drive
Urbandale, IA 50322
Phone: (515) 281-2644
Fax: (515) 242-4398
sweiss@midamerican.com

Suzan M. Stewart
Managing Attorney
P.O. Box 778
Sioux City, IA 51102
Phone: (712) 277-7587
Fax: (712) 252-7396
smstewart@midamerican.com

Jennifer S. Moore
Senior Attorney
106 East Second Street, P.O. Box 4050
Davenport, IA 51102
Phone: (563) 333-8006
Fax: (563) 333-8021
jsmoore@midamerican.com