

City/CUB/IEC Exhibit 2.0

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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**COMMONWEALTH EDISON COMPANY**

**Annual formula rate update and  
revenue requirement reconciliation  
under Section 16-108.5 of the  
Public Utilities Act.**

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**Docket No. 14-0312**

Rebuttal Testimony of

**Michael P. Gorman**

On behalf of

**City of Chicago, Citizens Utility Board  
and Illinois Industrial Energy Consumers**

August 13, 2014



159 Q IS THE DUPLICATIVE NATURE OF THESE PLANS SOMEHOW NEGATED BY  
160 THE FACT THAT THE AIP PROVIDES A CURRENT YEAR AWARD AND THE  
161 LTPP PROVIDES AN AWARD THAT VESTS OVER A THREE-YEAR PERIOD?

162 A No. It is clear from both my analysis of these plans and Mr. Prescott's rebuttal  
163 testimony that awards under both the AIP and the LTPP are being made as a result  
164 of achieving the same performance against the same goals.

165 Section 16-108.5 of the Public Utilities Act ("the Formula Rate Law") provides  
166 for recovery of incentive compensation based on the achievement of operational  
167 metrics such as safety, customer service and environmental compliance. However,  
168 the cost of incentive compensation for the same achieved performance should not be  
169 recoverable under multiple plans in the same compensation package.

170 Q WHAT IS YOUR RESPONSE TO MR. PRESCOTT'S ASSERTION THAT THE LTPP  
171 IS NECESSARY TO INCENT EMPLOYEES TO STAY WITH COMED?

172 A Longevity with the utility is not one of the examples of the operational metrics listed in  
173 the Formula Rate Law with regard to recovery of incentive compensation. In any  
174 event, I do not believe longevity with a utility should be considered an operational  
175 metric because it does not require specific actions to either control cost, improve  
176 utility service, or comply with environmental requirements. Its achievement should  
177 not be recognized for recovery in the formula rate process.

178 **RECONCILIATION BALANCE INTEREST**

179 Q PLEASE EXPLAIN THIS PORTION OF YOUR TESTIMONY.

180 A This portion of my rebuttal testimony will address the issue of the appropriate  
181 reconciliation balance on which interest should be calculated. I will respond to the

182 rebuttal testimonies of ComEd witnesses Warren (ComEd Ex. 23.0) and Brinkman  
183 (ComEd Ex. 12.0 REV.) regarding this issue.

184 **Q PLEASE SUMMARIZE MR. WARREN'S TESTIMONY REGARDING THIS ISSUE.**

185 A Mr. Warren describes two methods, which he refers to as models, for calculating  
186 interest on the reconciliation balance. He has labeled his two models as the  
187 "prescribed interest" model and the "cost-based" model and his testimony describes  
188 the parameters according to how each model calculates the interest for the  
189 reconciliation balance.

190 **Q HOW DOES MR. WARREN DESCRIBE EACH OF THESE MODELS?**

191 A Mr. Warren first compares the prescribed interest model as similar to the process of a  
192 bank charging interest on a loan balance. According to this model, Mr. Warren  
193 calculates interest by multiplying a rate by the reconciliation balance.

194 Second, Mr. Warren compares the cost-based model to a conventional  
195 regulatory calculation. According to the cost-based model, the reconciliation balance  
196 is reduced by accumulated tax benefits before being multiplied by a carrying charge  
197 rate. However, Mr. Warren assumes the carrying charge rate is based on 100%  
198 common equity capital and has proposed to gross-up the common equity carrying  
199 charge rate for income taxes.

200 **Q ARE THESE TWO MODELS THE ONLY METHODS APPLICABLE TO THE**  
201 **CALCULATION OF INTEREST ON THE RECONCILIATION BALANCE?**

202 A No. Mr. Warren seeks to establish that his two models are the only ones applicable  
203 to the calculation of interest on the reconciliation balance. While these two models

204 are not described in the Formula Rate Law (220 ILCS 5/16-108.5), by limiting the  
205 calculation of interest on the reconciliation balance to only these two models,  
206 Mr. Warren is able to reject any method that does not fit into the parameters he has  
207 established for each of his models. Although it may not follow either of Mr. Warren's  
208 models, I believe the method I discuss in my direct testimony produces the  
209 appropriate level of interest on the reconciliation balance in the context of the Illinois  
210 formula rate approach.

211 **Q WHY IS YOUR METHOD OF CALCULATING INTEREST APPROPRIATE?**

212 A First, I believe it is important to discuss the applicable interest rate. The Formula  
213 Rate Law clearly states that "interest" is being applied to the reconciliation balance.  
214 Although it is my understanding that the rate of interest is required by the Formula  
215 Rate Law to be equal to the weighted average cost of capital ("WACC"), it is not a  
216 rate of return, and it is my further understanding it is not referred to as such in the  
217 statute. It is simply the interest received in recognition of ComEd incurring a carrying  
218 cost for the reconciliation balance. Interest is tax deductible and should not be  
219 factored-up for taxes as suggested by Mr. Warren's second model.

220 Next, the reconciliation balance, to which this carrying cost should be applied,  
221 must be examined. In ComEd's case the reconciliation balance is positive, indicating  
222 that the cost of service was higher than the level reflected in rates. As I discussed in  
223 my direct testimony, these higher costs would result in less taxable income and a  
224 reduction in income taxes. This tax benefit results in a lower out-of-pocket cost  
225 associated with the reconciliation balance. A reconciliation balance, net of tax  
226 savings, reflects the balance that ComEd must actually carry and to which the interest  
227 rate should be applied.

228 **Q DO YOU BELIEVE THE COMMISSION HAS ACCEPTED THE PRESCRIBED**  
229 **INTEREST MODEL?**

230 A No. In its Final Order in Docket No. 13-0553, at page 43, the Commission stated that  
231 it found merit in the proposals of the Attorney General and the Citizens Utility  
232 Board/City of Chicago/Illinois Industrial Energy Consumers to reduce the  
233 reconciliation balance for tax benefits, prior to the application of the interest rate. The  
234 Commission also stated that:

235 This concept is consistent with Generally Accepted Accounting  
236 Principles, is consistent with standard regulatory practice that matches  
237 [accumulated deferred income tax] ADIT elements to the associated  
238 assets included in rate base and properly recognizes the cash benefit  
239 to the utility that would otherwise have been paid out for income taxes  
240 on the amount.

241 **Q IS YOUR PROPOSAL CONSISTENT WITH THE COMMISSION'S VIEW AS**  
242 **STATED ABOVE?**

243 A Yes. My proposal reflects the reduction of the reconciliation balance by the tax  
244 benefits in the calculation of interest. The position I am taking in this case is also  
245 consistent with the proposal I made in the previous formula rate case, Docket No.  
246 13-0318.

247 **Q WHY DID THE COMMISSION REJECT A REDUCTION TO THE RECONCILIATION**  
248 **BALANCE FOR ADIT, PRIOR TO THE CALCULATION OF INTEREST, IN THE**  
249 **DETERMINATION OF THE 2013 FORMULA RATE?**

250 A The Commission said that although the Formula Rate Law did not prohibit or require  
251 such accounting treatment, it was difficult to support an interpretation that read

252 into the statute exceptions, limitations, or conditions the legislature did not  
253 express.

254 As I discussed in my direct testimony, the specific inclusion of ADIT is only  
255 referenced in the Formula Rate Law with regard to calculating the pension asset. All  
256 other recognition of ADIT in formula ratemaking had to rely on Commission  
257 interpretation, since there was no specific wording in the Formula Rate Law that  
258 directed its recognition. In addition, my adjustment does not require changes to the  
259 formula rate schedule Sch FR A-4. This schedule, as filed by ComEd, provided for  
260 adjustments to the interest on the reconciliation balance on line 30a of SCH FR A-4.  
261 (ComEd Ex. 3.01 at 6). I have calculated the appropriate adjustment to the  
262 reconciliation interest to reflect a reduction of the reconciliation balance for the tax  
263 benefits on (Workpaper) WP 26, which flows to line 30a on Sch FR A-4 (CCI Ex. 1.02,  
264 line 32).

265 **Q ON PAGE 12 OF HIS REBUTTAL, MR. WARREN STATES THAT INCOME TAXES**  
266 **ARE ALREADY REFLECTED IN THE AMOUNT OF THE RECONCILIATION**  
267 **BALANCE. IS THIS CORRECT?**

268 **A** Yes. Approximately \$93 million of income taxes are included in the approximately  
269 \$227 million reconciliation balance. This reflects the income taxes that were not paid  
270 in 2013 as a result of the higher costs incurred. This is the amount by which the  
271 reconciliation balance should be reduced prior to the application of the interest rate.  
272 ComEd should not be allowed to collect a carrying cost on taxes that were saved.

273 **Q BEGINNING ON PAGE 27 AND CONTINUING THROUGH PAGE 29 OF HER**  
274 **REBUTTAL TESTIMONY, MS. BRINKMAN ARGUES AGAINST THE PREMISE**  
275 **THAT COMED HAS RECEIVED A PRESENT FINANCIAL BENEFIT THAT**  
276 **SHOULD REDUCE THE RECONCILIATION BALANCE PRIOR TO THE**  
277 **CALCULATION OF INTEREST. IS SHE CORRECT?**

278 A No. ComEd has received a tax benefit and a cash benefit, which is the reason that  
279 the interest rate should only be applied to the net of tax cash reconciliation balance.

280 **Q PLEASE DESCRIBE THE TAX BENEFIT RECEIVED BY COMED THAT IS**  
281 **ASSOCIATED WITH THE RECONCILIATION BALANCE?**

282 A On pages 28 and 29 of her rebuttal testimony, Ms. Brinkman states that in 2013,  
283 according to Generally Accepted Accounting Principles, the Company recorded an  
284 increase in revenue as a result of the probable future recovery of the reconciliation  
285 balance that was earned and measurable. According to Ms. Brinkman, this increased  
286 recognition of revenue also allowed ComEd to realize increased earnings in 2013.  
287 Further, Ms. Brinkman states that there is a book versus tax timing difference on the  
288 tax associated with that revenue recognition. Therefore, the Company records  
289 revenue in 2013 that is expected to be received in future periods and also records a  
290 deferred income tax expense related to the revenue recognition. The net impact is  
291 that the Company records higher earnings due to the reconciliation revenue, but  
292 delays payment of the income tax associated with the reconciliation revenue until the  
293 revenue is actually recovered from customers. In the present case the revenue  
294 recognized in 2013 will be recovered in 2015.

295 Payment of taxes on the reconciliation revenues is delayed, until the actual  
296 recovery of the reconciliation balance in 2015. As such, ComEd does not incur the

297 actual tax payment associated with reconciliation revenues until it is actually  
298 recovered. Hence, the income tax amount of the revenue requirement is not an  
299 out-of-pocket cost of ComEd until the revenue is actually recovered. As a result, the  
300 out-of-pocket cost to ComEd of the reconciliation balance is the after-tax  
301 reconciliation revenue requirement. The tax benefit to ComEd is the delay in income  
302 tax payments of \$93 million on the reconciliation revenue requirement until the  
303 revenue is actually recovered from customers, despite recording higher revenues and  
304 earnings.

305 **Q IS THERE ALSO A CASH BENEFIT RECEIVED BY COMED ASSOCIATED WITH**  
306 **THE RECONCILIATION BALANCE?**

307 A Yes. A positive reconciliation balance reflects the fact that ComEd incurred higher  
308 costs in 2013 than were anticipated when formula rates were established for that  
309 year. Therefore, ComEd would have enjoyed increased tax deductions and lower  
310 taxes as a result of these higher than anticipated costs. As a result, ComEd realized  
311 a cash benefit associated with lower tax payments in 2013 due to the higher costs  
312 reflected in the reconciliation balance.

313 **Q SHOULD THIS CASH BENEFIT BE REFLECTED IN THE CALCULATION OF THE**  
314 **RECONCILIATION BALANCE TO DETERMINE THE NET CASH INVESTMENT OF**  
315 **COMED?**

316 A Yes. The calculation of interest should reflect the interest rate applied to the gross  
317 reconciliation balance reduced by 41.175%, the composite income tax rate. This  
318 calculation reflects interest on ComEd's net cash investment in the reconciliation  
319 balance at an interest rate equal to the Company's WACC. I have presented this

320 calculation in my testimony as an adjustment to the reconciliation balance with  
321 interest calculated by ComEd on SCH FR A-4. (ComEd Ex. 3.01 at 6:31). The  
322 adjustment I propose is calculated on WP 26, attached to my direct testimony, and  
323 reflects interest on the tax benefit associated with the reconciliation balance. (CCI  
324 Ex. 1.02 at 1:32). The net of these two calculations reflects interest on only the net of  
325 tax cash investment of ComEd in the reconciliation balance.

326 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

327 **A** Yes, it does.

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