

Docket No: 15-0287
Bench Date: 12/09/15
Deadline: 12/11/15

MEMORANDUM

TO: The Commission

FROM: Terrance Hilliard, Heather Jorgenson, Administrative Law Judges

DATE: November 10, 2015

SUBJECT: Commonwealth Edison Company
Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act.

RECOMMENDATION: Enter attached Order.

I. PROCEDURAL HISTORY

On April 15, 2015, Commonwealth Edison Company (“ComEd”, or “the Company”) filed with the Illinois Commerce Commission (the “Commission” or “ICC”) ComEd’s annual formula rate update and revenue requirement reconciliation and requested the Commission authorize and direct ComEd to make the compliance filings necessary to place into effect the resulting charges to be applicable to delivery services provided by ComEd beginning on the first day of ComEd’s January 2016 billing period, as authorized by Section 16-108.5(d) of the Public Utilities Act (the “Act” or “PUA”), 220 ILCS 5/16 108.5(d).

ComEd’s filing included updated inputs to the performance-based formula rate for the applicable rate year (2016) that are based on final historical data reflected in the Utility’s most recently filed annual FERC Form 1 (for 2014) plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed (2015).

The filing also included a reconciliation of the revenue requirement that was in effect for the prior rate year (2014) (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (as reflected in the applicable FERC Form 1 (for 2014) that reports the actual costs for the prior rate year).

By statute, this docket must conclude on or before December 11, 2015.

In addition to ComEd and Staff, the following parties have submitted testimony in this case: the Illinois Attorney General’s Office (“AG”) and the City of Chicago (“City”) (collectively, “AG/City”), and the Citizens Utility Board (“CUB”) and the Illinois Industrial Energy Consumers (“IIEC”) (collectively, “CUB/IIEC” or “C/I”).

During the course of the proceeding, Staff and other parties recommended various adjustments and changes to the Company's proposed revenue requirements. ComEd accepted some of these adjustments and changes.

An evidentiary hearing was convened in this docket at the Commission's Chicago Office before duly authorized Administrative Law Judges on August 27, 2015. The parties filed and served Initial Briefs on September 9, 2015. Reply Briefs were filed and served on September 16, 2015. A Proposed Order was issued on October 19, 2015. Briefs on Exceptions were filed and served on October 27, 2015. Reply Briefs on Exceptions were filed and served on November 3, 2015.

II. ISSUES

A. Calculation of depreciation resulting in accumulated deferred income taxes ("ADIT") related to plant additions.

1. Analysis

ADIT reflects the temporary difference between when an expense (or revenue) is recognized in a company's financial and accounting records, commonly referred to as a company's "books," versus when the company recognizes that expense (or revenue) on its tax return. According to ComEd, deferred income taxes relate to future tax effects and can be classified as either deferred income tax liabilities or deferred income tax assets.

ADIT arises in several contexts, and the appropriate ratemaking treatment must correspond with how the ADIT is created and how it affects ComEd's costs.

The Commission addressed how ComEd should calculate depreciation related to projected plant additions in its recent Final Order in ComEd's Petition to Make Housekeeping Revisions and a Compliance Change to filed Rate Formula, Docket No. 14-0316, ("Housekeeping Order") a determination which no party appealed.

C/I recommend a change to the calculation of depreciation resulting in ADIT related to plant additions that according to ComEd conflicts with a prior Commission decision. C/I claim that ADIT associated with 2015 plant additions should reflect the first year tax depreciation less the comparable first year book depreciation expense, multiplied by the combined effective income tax rate. C/I showed that first year tax depreciation rates are less than the full-year rates, in recognition of the fact that the plant additions occur throughout the year. Therefore, C/I state the amount should be compared to a book depreciation expense that also reflects the fact that 2015 plant additions occur throughout the year. C/I argue the correct calculation and comparison reduces rate base by approximately \$9.5 million and the Company's revenue requirement by approximately \$0.9 million.

Staff agrees with ComEd's position and notes that the Commission approved this same method less than a year ago in Docket 14-0316.

2. Recommendation

The evidence shows that ComEd calculated its depreciation and ADIT balances in accordance with the Commission's directive in the Housekeeping Order. The Commission determined last year that the methodology that ComEd followed here "provides the best projection of the depreciation expense for the filing year." Housekeeping Order at 26. Staff contends that no changed circumstance warrants adopting a different method for determining the depreciation or the ADIT balance. The evidence establishes that the full-year measure of depreciation the Commission approved and that ComEd uses will both "limit the reconciliation adjustment that will be required in the formula rate proceeding" and "will minimize any interest that would impact customer rates subsequent to the reconciliation." *Id.* This method is likely to result in a more accurate estimate of the rate year revenue requirement. We recommend that the Commission adopt ComEd's position.

B. ADIT Related to Bad Debt

1. Analysis

The AG/City and C/I recommend a change to the way ADIT related to bad debt is reflected in the revenue requirement. ComEd contends this conflicts with a recent Commission decision and fundamentally misunderstands the role of ADIT in ratemaking.

ComEd asserts that its treatment of bad debt related ADIT in this Docket is consistent with past calculations and treatment in prior formula rate case revenue requirements. AG/City propose an \$18.5 million rate base disallowance of this deferred tax asset. C/I also adopt that position in their briefs.

Bad debt expenses are "booked" prior to their recognition as the basis for a tax deduction and ComEd must satisfy the resulting tax liability in advance. That tax prepayment is an asset funded by ComEd and one that ComEd asserts it is entitled to include in rate base. The argument is made by the AG that the book entries in Account 144 must be "offset" against that balance. Account 144 represents a book allowance for the portion of Accounts Receivable the Company anticipates will not be collected. It does not reflect any cash nor does it provide any source of funds that ComEd can use to pay any part of the prepaid tax liability the ADIT measures. The balance in that account does not, therefore, offset the ADIT that ComEd has actually funded.

AG/City argue that ComEd will recover the cost of its tax prepayment through its uncollectibles recovery rider. ComEd contends its Uncollectibles Expense Rider only recovers the cost of ComEd's uncollectibles that are actually written off. The additional cost the company incurs in connection with the prepaid tax, which is measured by the ADIT on bad debt – is not recovered through that rider.

2. Recommendation

The Order rejects the proposed disallowance, which is based on the argument that ComEd will recover the cost of its tax prepayment through its Uncollectibles Expense Rider. ComEd's Uncollectibles Expense Rider only recovers the cost of the portion of Accounts Receivable the Company anticipates will not be collected. The additional cost

the Company incurs in connection with the prepaid tax, which is measured by the ADIT on bad debt – is not recovered through that rider. We recommend that the Commission adopt ComEd’s position as stated in the Order but further recommend language that directs the parties to offer an alternative recovery mechanism if the adjustment is offered for consideration in a future proceeding .

C. ComEd’s Materials and Supplies (“M&S”) balance

1. Analysis

ComEd describes its Materials & Supplies (“M&S”) balance as “an inventory of distribution equipment to support its capital projects and to replace necessary equipment, including an emergency reserve.” ComEd Init. Br. at 23. ComEd states its M&S balance of \$52.7 million represents its inventory at year-end 2014 as reflected in its Federal Energy Regulatory Commission (“FERC”) Form 1. ComEd requests that the Commission approve this amount and reject C/I witness Mr. Gorman’s proposed \$20.7 million rate base disallowance to ComEd’s M&S inventory balance, which would reduce ComEd’s revenue requirement by approximately \$4.3 million.

C/I propose using a year-over-year average amount for ComEd’s M&S inventory balance instead of ComEd’s actual FERC Form 1 figures. C/I argue that ComEd has not justified its increase in M&S inventory balance and recommend the Commission adopt their adjustment reducing ComEd’s M&S.

ComEd argues that this adjustment is contrary to the language of the Energy Infrastructure and Modernization Act (“EIMA”). ComEd also argues that it is also contrary to Commission rulings in every other ComEd formula rate case, and the Commission’s recent decision on this exact issue in Ameren’s 2014 formula rate case, Docket No. 14-0317. ComEd argues that C/I’s proposal is contrary to the language of EIMA, which states that the formula rate must use the utility’s “actual costs.” 220 ILCS 5/16-108.5(c). Specifically, the formula rate must use “final historical data reflected in the utility’s most recently filed annual FERC Form 1. 220 ILCS 5/16-108.5(d)(1). ComEd notes that EIMA further provides that differences in costs from year to year “shall not imply the imprudence or unreasonableness of that cost or investment,” and “[n]ormalization adjustments shall not be required.” 220 ILCS 5/16-108.5(c)(1); 220 ILCS 5/16-108.5(d)(3).

2. Recommendation

We recommend the Commission adopt ComEd’s position as articulated in the Order. C/I’s averaging or normalization methodology is contrary to Commission practice in ComEd’s prior formula rate cases. In each of those cases, the Commission used ComEd’s actual year-end M&S balances.

C/I argued that the level and growth of the M&S balance should match the level and growth of the distribution plant and maintenance but provided no direct evidence that there is, or should be, a one to one correspondence between them.

The Order recognizes that excessive inventory increases rate base and that the dollar amount of inventories has increased dramatically relative to plant additions in this filing. To protect against excessive inventory and or double counting of inventory, the

Order directs ComEd to provide specific justification for significant increases in year end inventory balances by supply category in future formula rate filings.

D. Disallowance of short term incentive compensation program expenses associated with distinguished performance by ComEd employees

1. Analysis

Staff proposes to disallow a portion of ComEd's Annual Incentive Program ("AIP") expense that is associated with ComEd employees' distinguished level of achievement. Staff argues it is not reasonable for ComEd to recover the entirety of AIP costs that ComEd determined using a 200% payout for each individual AIP metric. Staff proposes to reduce the maximum payout level for each AIP metric from 200% to 150%. C/I recommend the Commission adopt Staff's adjustment.

ComEd argues that Staff's position is arbitrary and capricious. ComEd states the expense is prudent and reasonable, that the AIP is consistent with EIMA and Commission practice, and that customers have benefited.

Staff argues its adjustment will allow ComEd to recover market level compensation plus a reasonable bonus. ComEd argues that it provided evidence indicating ComEd employees' distinguished achievement has benefited customers in excess of the cost of the commensurate AIP payout. However, Staff asserts there is no evidence in the record showing that lowering the bonus would provide any disincentive for employees to produce the maximum available benefits for ratepayers, especially considering that a 150% payout level is consistent with the maximum payout level for distinguished performance under LTCAP, and consistent with the incremental payout percentages for lower performance thresholds in the AIP.

2. Recommendation

The Order finds that the use of the 200% payout inflates the AIP costs beyond what is necessary to provide market level compensation plus a reasonable bonus. ComEd provides no evidence showing that reducing the payout to 150% would result in a compensation level that would be below market levels. ComEd's argument that Staff's disallowance sends a message to ComEd employees that they should try to be good but not great is pure speculation. Staff's proposal to limit the payout to 150% is reasonable and equitable, supported by record evidence, and not inconsistent with EIMA. We recommend that the Commission adopt Staff's adjustment.

E. Disallowance of ComEd's 401(k) Employee Savings Plan matching program

1. Analysis

Staff proposes an adjustment to disallow ComEd's Employee Savings Plan ("ESP") profit-sharing matching contribution. Staff argues that the ESP profit-sharing match included in ComEd's revenue requirement resulted from the achievement of

earnings per share goals established by the Compensation Committee of Exelon's Board of Directors. C/I and AG/City did not comment on this issue.

ComEd argues that Staff seeks to expand the provisions of 220 ILCS 5/16-108.5(c)(4)(A) and the so-called "customer benefit" test beyond the specific and narrow application to incentive compensation expenses to disallow 401(k) ESP expenses. ComEd argues this is contrary to the language of EIMA and Commission practice.

ComEd argues that its ESP expense is not prohibited by Commission practice or EIMA. Staff maintains that the profit sharing match is inconsistent with Commission practice and the law. ComEd is correct that the profit sharing matching contribution based on earnings per share is not specifically prohibited by EIMA. However, the Commission must still determine that the costs are prudent and reasonable. 220 ILCS 5/16-108.5(c)(1). Whether such an expense is consistent with Commission practice is not clear. This issue has not been addressed in prior proceedings. While this expense has been in existence since 2010, the fact that Staff did not object to it prior to the current proceeding is irrelevant.

These costs are not incentive compensation, where there is a statutory prohibition of compensation based on earnings per share. Nevertheless, the profit sharing match results from the achievement of earnings per share goals established by the Compensation Committee of Exelon's Board of Directors and primarily benefits shareholders. Moreover, as Staff notes, the profit sharing matching contribution increased the cost of the ESP in two of the five years, is variable, and does not guarantee savings to ratepayers.

2. Recommendation

We recommend that the Commission accept Staff's adjustment to disallow ComEd's ESP profit-sharing matching contribution because it is based on earnings per share goals established by Exelon's Board of Directors and because it primarily benefits shareholders.

F. Disallowance of outside services expenses associated with smart meter customer outreach and education

1. Analysis

Staff recommends disallowance of outside services expenses associated with ComEd's smart meter customer outreach and education program known as "#SmartMeetsSweet." or ("SMS"). This program involved distributing free ice cream and cookies to present customers with information about smart meters. Staff notes that only a small percentage of the costs of the program were related to customer education. Staff contends that most of the expense was more properly considered a corporate good will activity.

ComEd argues that Staff's recommendation is based on a misunderstanding of the outreach program and an impermissible hindsight review. ComEd urges the Commission to reject Staff's argument.

Staff asserts that the evidence demonstrates that the primary purpose of the SMS initiative was to enhance the Company's image in the communities it serves through goodwill advertising. ComEd recorded the expense for the SMS initiative in its financial records as marketing expense.

2. Recommendation

We recommend that the Commission adopt Staff's position disallowing the SMS initiative expenses.

ComEd spent in excess of \$500,000 distributing free ice cream and cookies to contact, at most, 36,000 customers about smart meters.

The evidence demonstrates that the primary purpose of the SMS initiative was to enhance the Company's image in the communities it serves through goodwill advertising. As Staff notes, ComEd recorded the expense for the SMS initiative in its financial records as marketing expense. Such expenses are not recoverable under Section 9-225 of the Act. Only after Staff proposed an adjustment to disallow recovery of the expense did ComEd decide the expense was misclassified and should be considered customer service and informational expense.

Only 5% of the SMS funds were spent on educational materials. Management fees, vehicles and staffing comprised 84% of the expenditure. Another 11% was spent on insurance, site fees and other miscellaneous costs. Thus, few customers were contacted and little was spent on educational materials relative to the cost of the initiative. The Order agrees with Staff that this was unrecoverable goodwill or institutional advertising that was neither prudently incurred nor reasonable in amount. The Order finds that it would be unreasonable to impose the costs of the SMS initiative on ComEd's customers.

G. Disallowance of certain industry association dues

1. Analysis

Staff seeks to disallow 100% of the industry association dues for both the Illinois Environmental Regulatory Group ("IERG") and the Utility Solid Waste Activities Group ("USWAG"). Staff argues the main purpose of these organizations is regulatory advocacy.

ComEd argues that only a portion of the dues are attributable to regulatory advocacy. ComEd urges the Commission to only disallow the percentage of the dues related to such activity as calculated by ComEd.

Section 9-224 of the Act clearly prohibits utilities from listing as an expense for the purpose of determining any rate or charge any amount expended for political activity or lobbying. In that regard, any industry association dues that are used for political activity and lobbying should be disallowed.

When a utility lists as an expense industry association dues for an association that engages in some regulatory advocacy or lobbying, the utility should provide sufficient evidence in this type of proceeding to determine what portion of those dues are

attributable to regulatory advocacy or lobbying and what portion is related to other activities. Both ComEd and Staff agree that USWAG and IERG engage, at least to some extent, in regulatory advocacy.

ComEd provides two documents as evidence in support of its position: (1) a letter to EEI members stating that 6.2% of dues assessed to USWAG are related to non-deductible activities; and (2) a general IERG Lobbying Statement.

2. Recommendation

We recommend adopting ComEd's position for dues relating to USWAG, and Staff's position for dues relating to IERG. The Order finds that the EEI letter is sufficient evidence to support disallowing only 6.2% of dues to USWAG. The Order finds that the general IERG Lobbying Statement is insufficient evidence to support that only 1% of IERG dues is related to lobbying activity for 2014. Therefore, we recommend the Commission adopt Staff's proposal to disallow 100% of dues to IERG.

H. Merger Expense

1. Analysis

The parties are agreed on the Illinois portion of merger expenses attributable to the proposed merger of Exelon and Pepco Holdings, Inc. However, on September 25, 2015 the District of Columbia Public Service Commission ruled against the proposed merger. Although that decision may be revised or reversed prior to the entry of the final order in this docket, if it is not reversed or revised the merger will not take place. If the merger does not occur the ComEd portion of merger expenses will not be properly chargeable to ComEd ratepayers.

The parties to this proceeding have agreed that if the merger has not closed by December 1, 2015, ComEd will withdraw its request that merger related costs be assessed in this Order. The Order contains alternative language accommodating both outcomes. ComEd will notify the Commission of the status of the merger on December 2, 2015. The non-conforming language should then be stricken from the Order.

2. Recommendation

We recommend that the Commission adopt this Order after December 2, 2015 after deleting the superfluous alternative merger expense language.

III. CONCLUSION

The Commission should enter the attached Order (subsequent to the resolution of the merger expense issue on, or about, December 2, 2015). The deadline for Commission action is December 11, 2015.

TH/HJ:fs