STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	**:**	
	:	**07-0566**
Proposed general increase in electric rates.	**:**	
(Tariffs filed October 17, 2007)	**:**	

ORDER

September 10, 2008

TABLE OF CONTENTS

I. Introduction 1

A. Procedural History 1

II. Overall Revenue Requirement and Revenue Deficiency 4

III. Test Year 5

IV. Rate Base 5

A. The Stipulation 6

B. Uncontested Issues 12

1. Plant 12

a) Major Capital Additions (Schedule F-4 Projects) 12

b) Capitalized Incentive Compensation Not Allowed in 2005 Rate Case 12

c) Capitalized Information Technology Costs 12

d) Merger Costs 12

e) Contested Staff-Proposed Adjustments That Are Uncontested If the Set of Resolutions Reflected in the Stipulation Is Approved 12

2. Construction Work in Progress (“CWIP”) 15

3. Materials and Supplies 15

4. Other Post-Employment Benefits (“OPEB”) 15

C. Contested Issues 15

1. Plant 15

a) Pro Forma Capital Additions 15

(1) Propriety of Additions 15

(2) Impact on Test Year Rate Base 18

b) Underground Cable and Services 32

c) Capitalized Incentive Compensation Other Than That in Section IV.B.1.b. (see V.C.1) 47

d) Customer Advances for Construction 47

e) Depreciable Life of Post-2006 Project 48

2. Accumulated Provisions for Depreciation and Amortization 51

3. Accumulated Deferred Income Taxes (“ADIT”) 51

D. Approved Rate Base 51

V. Operating Expenses 52

A. Overview 52

B. Uncontested Issues 52
1. Storm Expense 52
2. Rate Case Expenses 52
a) Rate Case Expenses of the Instant Case 52
b) Original Cost Audit Legal Expenses 53
3. Advertising 53
4. Charitable Contributions 53
5. Lobbying 53
6. "Non-recurring" Expenses (AT&T Lease) 54
7. Derivative Impact of Capitalized Incentive Compensation Not Allowed in 2005 Rate Case (See IV.B.1.b.) 54
C. Contested Issues 54
1. Incentive Compensation Cost and Expenses 54
f) Commission Analysis and Conclusion 61
2. Uncollectibles Expenses (Derivative Adjustment) 61
3. Merger Expenses 62
4. Administrative and General ("A&G") Expenses 65
a) Exelon Way Severance Amortization 65
b) Accounts 920-923 67
c) Rate Case Expenses 70
(1) 2005 Rate Case Expenses Amortization 70
(2) 2005 Rate Case Expenses in the 2006 Test Year 70
(3) 2005 Rate Case Rehearing Expenses in the 2006 Test Year 70
5. New Business Revenue Credit 74
6. Depreciation and Amortization Expenses (Derivative and Direct Adjustments) 76
7. Taxes Other than Income Taxes (Derivative Adjustments) 76
8. Income Taxes (Derivative Adjustments) 76
D. Operating Expenses (Total) 76
VI. Rate of Return 77
A. Capital Structure (Uncontested) 77
B. Cost of Long-Term Debt (Uncontested) 78
C. Cost of Common Equity 78
D. Overall Cost of Capital (Derivative) 99

E. Effects of Riders SMP and SEA on Cost of Capital 99
VII. New Riders 103
A. Rider UF....103
B. Rider SMP – Systems Modernization Projects Adjustment....103
C. Rider SEA – Storm Expense Adjustment....143
D. Rider SAC – Supply Administration Charge....159
VIII. Cost of Service and Allocation Issues....159
IX. Rate Design 213
A. Overview 213
B. Uncontested....214
C. Contested....214
1. Residential....214
a) Residential Customer Charge 214
2. Non-Residential 215
a) Space-heating customers....215
b) Railroad customers 218
(1) Power Supply Issue 218
(2) Public Policy and the Railroad Class....220
(3) The CTA Contract with ComEd 223
c) Primary and Secondary Billing Proposal....225
D. Existing Riders 227
1. Rider ACT....227
2. Rider AC7....229
3. Rider ML [and Rider SBO7] (Uncontested) 229
4. Rate MSPS7 [and Rate BES-H] (Uncontested)....230
E. Distribution Loss Factors....230
F. Recovery of Supply-Related Costs....232
G. Competitive Retail Market Development Issues 232
X. Revenues....233
A. Miscellaneous Revenues....233
B. Weather Normalization....233
XI. Other....234
A. Annual Reporting on Changes in Accounting Policy....234
B. Reporting on Affiliate Interest Transactions (Uncontested) 234

C. Reporting on Pass-Through Transactions (Uncontested) 234
D. Future Depreciation Studies (Uncontested) 235
E. Response to ALJ Post –Record Data Request 235
XII. Findings and Ordering Paragraphs..235

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	**:**	
	:	**07-0566**
Proposed general increase in electric rates.	**:**	
(Tariffs filed October 17, 2007)	**:**	

ORDER

I. Introduction

A. Procedural History

On October 17, 2007, Commonwealth Edison Company ("ComEd") filed with the Illinois Commerce Commission ("Commission"), pursuant to Section 9-201 of the Public Utilities Act ("Act"), 220 ILCS 5/9-201, the following tariff sheets: Ill. C.C. No. 4, 3rd Revised Sheet No. 296; 4th Revised Sheet No. 297; 2nd Revised Sheet No. 306; 3rd Revised Sheet No. 307; 3rd Revised Sheet No. 313; 2nd Revised Sheet No. 314; 2nd Revised Sheet No. 322; 2nd Revised Sheet No. 323; 2nd Revised Sheet No. 324; 3rd Revised Sheet No. 334; 6th Revised Sheet No. 336; 2nd Revised Sheet No. 340; 2nd Revised Sheet No. 347; 2nd Revised Sheet No. 348; 3rd Revised Sheet No. 349; 2nd Revised Sheet No. 354; 3rd Revised Sheet No. 368; 3rd Revised Sheet No. 369; 3rd Revised Sheet No. 370; 3rd Revised Sheet No. 371; 3rd Revised Sheet No. 372; 2nd Revised Sheet No. 378; 2nd Revised Sheet No. 402; 2nd Revised Sheet No. 403; 2nd Revised Sheet No. 404; 2nd Revised Sheet No. 451; 3rd Revised Sheet No. 452; 2nd Revised Sheet No. 453; 2nd Revised Sheet No. 454; 3rd Revised Sheet No. 472; 2nd Revised Sheet No. 573; 2nd Revised Sheet No. 574; 1st Revised Sheet No. 591; Original Sheet Nos. 621 through 629. This rate filing embodied a general increase in electric rates and revised other terms and conditions of service. The tariff filing was accompanied by direct testimony, exhibits, and other materials required under Part 285 and Part 286 of Title 83 of the Illinois Administrative Code. 83 Ill. Admin. Code Parts 285 and 286.

Notice of the proposed tariff changes reflected in this rate filing was posted in ComEd's business offices and published in a secular newspaper of general circulation in ComEd's service area, as evidenced by publisher's certificates, in accordance with the requirements of Section 9-201(a) of the Act, 220 ILCS 5/9-201(a), and the provisions of 83 Ill. Admin. Code 255.

The Commission issued a Suspension Order on November 28, 2007, suspending the Tariffs to and including March 14, 2008, and initiating this proceeding. On February

27, 2008, the Commission issued a Resuspension Order, suspending the Tariffs to and including September 14, 2008.

In response to the Company's filing, the following parties filed Petitions to Intervene, which were granted by the Administrative Law Judges ("ALJs"): Citizens Utility Board ("CUB"); People of the State of Illinois ("AG") (collectively, the AG and CUB are referred to as "AG/CUB"); the City of Chicago ("City"); Illinois Industrial Energy Consumers ("IIEC"); American Association of Retired Persons ("AARP"); the Building Owners and Managers of Chicago ("BOMA"); the Commercial Group ("CG" an ad hoc group composed of the Illinois Retail Merchants Association, Best Buy Co, Inc., J.C. Penny Corporation Inc., Macy's Inc., Safeway, Inc. and Wal-Mart Stores, Inc.); Constellation NewEnergy, Inc. ("CNE"); the Chicago Transit Authority ("CTA"); United States Department of Energy ("DOE"); International Brotherhood of Electrical Workers, AFL-CIO (Local 15) ("IBEW"); the Kroger Company ("Kroger"); Northeast Illinois Commuter Regional Commuter Railroad Corporation, d/b/a Metra ("Metra"); Nucor Steel Kankakee, Inc. ("Nucor"); Request Equitable Allocation of Costs Together ("REACT" comprised of: A. Finkl & Sons, Co., Alsip Paper Condominium Association, Aux Sable Liquid Products, LP., The City of Chicago, Commerce Energy, Inc., Flint Hills Resources, LLC, Integrys Energy Services, Inc., PDV Midwest Refining LLC, United Airlines, Inc., and Wells Manufacturing, Inc.); and Retail Energy Supply Association ("RESA").

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission, status hearings were held on December 12, 2007 and April 25, 2008, before duly authorized Administrative Law Judges ("ALJs") at the Commission's offices in Chicago, Illinois. Evidentiary hearings were held April 28, 2008 through May 5, 2008. At the conclusion of the hearing on May 5, 2008, the record was marked "Heard and Taken."

The following witnesses submitted testimony on behalf of ComEd: J. Barry Mitchell (ComEd Ex. 1.0, ComEd Ex. 17.0, ComEd Ex. 34); Susan D. Abbott (ComEd Ex. 2.0 Corr., ComEd Ex. 35); Robert W. Gee (ComEd. Ex. 3.0, ComEd Ex. 20.0); George A. Williams (ComEd Ex. 4.0 2nd Corr., Ex. 22.0 2nd Corr., ComEd Ex. 37); Michael B. McMahan (ComEd. Ex. 5.0 Corr.); Sally Clair (ComEd. Ex. 6.0, ComEd Ex. 16.0, ComEd Ex. 23 Corr., ComEd Ex. 38); Kathryn M. Houtsma and Stacie Frank (ComEd. Ex. 7.0 Corr., 7.1 part 1, 7.1 part 2, 7.2 part 1, 7.2 part 2, 7.3 Corr., 7.4, ComEd Ex. 25.0 Corr., ComEd Ex. 40 Corr.); Thomas J. Flaherty (ComEd. Ex. 8.0); Robert K. McDonald (ComEd. Ex. 9.0, ComEd Ex. 28, ComEd Ex. 41.0); Samuel D. Hadaway (ComEd. Ex. 10.0, ComEd Ex. 29, ComEd Ex. 42.0); Paul R. Crumrine (ComEd. Ex. 11.0 Corr., ComEd Ex. 30.0, ComEd Ex. 43.0 Corr.); Lawrence S. Alongi and Chantal Jones (ComEd. Ex. 12.0, ComEd Ex. 32 Corr., ComEd Ex. 45.0); Alan C. Heintz (ComEd. Ex. 13.0 Corr., ComEd Ex. 14.0, ComEd Ex. 33.0 Corr.); Terence R. Donnelly (ComEd. Ex. 15.0, ComEd Ex. 21 Corr., ComEd Ex. 36); Susan Tierney (ComEd. Ex. 18.0); Kevin J. Waden (ComEd. Ex. 26.0); Joseph A. Frangipane (ComEd. Ex. 27.0); Stephen S. George (ComEd. Ex. 31.0); Robert Donohue (ComEd. Ex. 39.0) along with the exhibits accompanying their respective testimonies.

IIEC offered the testimony of Mr. Michael Gorman (Gorman Direct, IIEC Ex. 2.0-C (Public) and Conf. Ex. 2.0-C (Confidential); and Rebuttal, IIEC Ex. 6.0-C (Public) and Conf. Ex. 6.0-C (Confidential)), Mr. Robert R. Stephens (Stephens Direct, IIEC Ex. 1.0-C; Supplemental Direct, IIEC Ex. 4.0; and Rebuttal, IIEC Ex. 5.0), and Mr. David L. Stowe (Stowe, Direct, IIEC Ex. 3.0-C; and Rebuttal, IIEC Ex. 7.0), along with the exhibits accompanying their respective testimonies.

CNE submitted the Supplemental Direct Testimony and Rebuttal Testimony of David I. Fein as CNE Exs. 1.0 and 2.0, respectively.

AARP submitted the Direct Testimony and Rebuttal Testimony of Ralph C. Smith as AARP Exs. 1.0 and 2.0, respectively.

The following witnesses submitted testimony on behalf of the Staff of the Illinois Commerce Commission ("Staff"): Dianna Hathhorn (Staff Ex. 1.0; Staff Ex. 10.0; Staff Ex. 14.0); Thomas L. Griffin (Staff Ex. 2.0 Corr.; Staff Ex. 15.0 Corr.); Mike Ostrander (Staff Ex. 3.0; Staff Ex. 16.0); Michael McNally (Staff Ex. 4.0 Corr.; Staff Ex. 17.0); Mike Luth (Staff Ex. 6.0 (adopted by Peter Lazare); Staff Ex. 11.0 (adopted by Peter Lazare); Peter Lazare (Staff Ex. 5.0; Staff Ex. 18.0); Qin Liu (Staff Ex. 7.0); Ronald Linkenback (Staff Ex. 8.0; Staff Ex. 12.0); Eric P. Schlaf (Staff Ex. 9.0; Staff Ex. 20.0; Staff Ex. 20.1); and Harold L. Stoller (Staff Ex. 13.0; Staff Ex. 21.0) along with the exhibits accompanying their respective testimonies.

The AG offered the testimony of Scott J. Rubin (AG Ex. 2.0, AG Ex. 6.0) and (AG Ex. 4.0). Jointly with CUB, the AG offered the testimony of Peter J. Lanzalotta (AG/CUB Ex. 7.0 Prop.), Michael L. Brosch (AG/CUB Ex. 1.0, AG/CUB Ex. 3, AG/CUB Ex. 4.0) and David Effron (AG/CUB Ex. 2.0, AG/CUB Ex. 5.0, and AG/CUB Ex 8.0) along with the exhibits accompanying their respective testimonies.

Nucor offered the direct testimony of Dr. Dennis W. Goins (Nucor Ex. 1.0).

The CG offered the testimony of David F. Vite (CG EX.1 Rebuttal, Richard Baudino CG Ex. 2.0 Rebuttal).

CUB offered the testimony of Christopher C. Thomas (CUB Ex. 1.0 Direct, CUB Ex. 4.0 Rebuttal); Martin Cohen (CUB. Ex.3.0 Supp. Direct, CUB. Ex.6.0 Rebuttal); L. Lynn Kiesling (CUB Ex. 2.0 Supp. Direct, CUB 5.0 Rebuttal) along with the exhibits accompanying their respective testimonies.

The CTA offered the testimony of Dennis Anosike (CTA Ex.1 Direct); Glen Zika (CTA. Ex. 4.0 Rebuttal); jointly with Metra the testimony of James G. Bachman (Metra/CTA Jt. Ex. 1.0 Direct, Jt. Ex 2.0 Supp. Direct, Jt. Ex. 3.0 Rebuttal) along with the exhibits accompanying their respective testimonies.

Metra offered the testimony of James Mitchell (Metra Ex. 1 Direct, Metra Ex. 4.0 Rebuttal); Wes Zerla (Metra Ex. 2.0 Direct, Metra 5.0 Rebuttal); and Lynette Ciavarella (Metra Ex. 3.0 Direct) along with the exhibits accompanying their respective testimonies.

Kroger Co. offered the testimony of Kevin C. Higgins (Kroger Ex. 1 Direct).

REACT offered the testimony of Bradley O. Fults (REACT Ex. 1.0 Direct, REACT Ex. 4.0 Supp. Direct, REACT Ex. 5.0 Rebuttal); Edward C. Bodmer (REACT Ex. 2.0 Direct, REACT Ex. 6.0 Rebuttal); Jeffrey Merola (REACT Ex. 3.0 Direct, REACT Ex. 7.0 Rebuttal) along with the exhibits accompanying their respective testimonies.

The DOE offered the testimony of Dale E. Swan (DOE Ex. 1 Direct, DOE Ex. 2 Rebuttal) along with the exhibits accompanying his testimony.

BOMA offered the testimony of Ralph Zarumba (BOMA Ex. 1 Direct, BOMA Ex. 3 Supp. Direct, BOMA Ex. 5.0 Rebuttal); Guy Sharfman (BOMA Ex. 2 Direct, BOMA Ex. 4.0 Rebuttal) along with the exhibits accompanying their respective testimonies.

The City of Chicago offered the testimony of Edward C. Bodmer (City Ex. 1.0 Direct, City Ex. 2.0 Rebuttal) along with the exhibits accompanying his testimony.

RESA offered the testimony Roy Boston (RESA Ex. 1).

Initial Briefs were filed on May 29, 2008 by CNE, CG, AARP, DOE, CTA, Nucor, Kroger, Staff, ComEd, RESA, the AG, CUB, BOMA, REACT, and Metra; and on May 30, 2008 by the City and IIEC. Reply Briefs were filed on June 16, 2008 by CG, CNE, CTA, Metra, ComEd, IIEC, AARP, RESA, REACT, Staff, the AG, CUB, Nucor, BOMA, and the City.

The ALJs' Proposed Order was served on July 10, 2008. Briefs on Exceptions were filed July 24, 2008. Replies to Exceptions were filed July 31, 2008.

II. Overall Revenue Requirement and Revenue Deficiency

ComEd originally presented and supported with detailed evidence a revenue requirement, including income taxes and after the subtraction of other revenues, of $2,048,826,000, representing a revenue deficiency (under recovery of costs of service) under existing rates of $361,334,000, driven largely by increases in plant investment and operating and maintenance expenses. ComEd Ex. 7.0 Corr. at 4, 45; ComEd Ex. 7.1, Sched. C-1.

ComEd presented and supported with detailed evidence a final revised revenue requirement of $2,032,896,000, which reflects a revenue deficiency under existing rates of $345,404,000. See ComEd Ex. 40.0 Corr. at 3; ComEd Ex. 40.01, Scheds. RB-1, RR 1; and the supporting Work Papers in ComEd Ex. 40.02. Under a Stipulation with Staff (Staff/ComEd Jt. Ex. 1, the "Stipulation"), for purposes of this case, ComEd consents to limit its rate increase request to $314,451,000 and would support a revenue requirement of $2,001,943,000, as part of its joint recommendations with Staff ("the Staff/ComEd joint recommendations"). See ComEd Ex. 40.0 Corr. at 3; ComEd Ex. 40.01, Sched. RB-1, columns (I) through (J), and Sched. RR 1, columns (E) through (I); and the supporting Work Papers in ComEd Ex. 40.02.

The AG calculates a revenue deficiency of $43,993,000.

IIEC did not present a proposed revenue deficiency, but IIEC did propose certain rate base and operating expenses adjustments.

Staff recommends revenues of $2,078,545,000 as reflected on page 1, line 5, column (i) of Appendix A to Staff's Initial Brief. This is an increase of $262,042,000, or 14.43%, to ComEd's pro forma present revenues of $1,816,503,000.

In response to the Proposed Order, Staff and ComEd continue to propose and contend that, for purposes of this case, the Commission should approve the set of recommendations provided for in the Stipulation. They state that those recommendations are each supported by the evidence in the record and/or reflect concessions by ComEd conditionally proposed as part of those recommendations.

In their Briefs on Exceptions, Staff and ComEd propose for purposes of this case that, if the Commission approves the set of recommendations provided for in the Stipulation, then the Commission also should approve an additional set of recommendations. The additional set of recommendations is as follows: (1) Staff and ComEd would be willing to accept, *i.e.*, to not pursue their Exceptions to, the Proposed Order's recommended resolutions of all rate base and operating expenses in Sections IV and V and the recommended overall rate of return ("ROR") of 8.36% and the recommended rate of return on common equity ("ROE") of 10.30% in Section VI; except and provided that (2) the Commission approves as a combined set of issue resolutions (a) ComEd's agreeing for purposes of this case to forego inclusion in rate base of its *pro forma* capital additions for the third quarter of 2008 that were recommended to be approved in Section IV(C)(1) of the Proposed Order and (b) the Commission's rejecting the proposed adjustments to the Depreciation Reserve and Accumulated Deferred Income Taxes (ADIT) that were recommended in Section IV(C)(1) of the Proposed Order or any other such adjustments to rate base for post-test year depreciation and/or deferred income taxes related to test year plant. Staff and ComEd state that their willingness to accept any and all issue resolutions contrary to their evidence and their briefing is not to be understood as their agreeing with the merits of such resolutions nor to bind them or to constitute an admission for purposes of any future proceedings in any other Commission dockets or otherwise.

The Commission has reviewed the evidence regarding the issues that are the subject of the proposed set of recommendations in the Stipulation and the additional set of recommendations. The Commission decides the issues as discussed individually below.

III. Test Year

ComEd selected the historical test year of 2006. That test year is uncontested.

IV. Rate Base

ComEd originally proposed a rate base of $7,071,234,000. ComEd Ex. 7.0 Corr. at 4, 12-13; ComEd Ex. 7.1, Sched. B-1. ComEd, in rebuttal, proposed and supported a rate base of $7,016,919,000, a reduction of $54,315,000 from its original proposal, that reflected ComEd's analysis of Staff and Intervenor proposed adjustments to rate base. ComEd Ex. 25.0 Corr. at 3; ComEd Ex. 25.01, Sched. B-1.

Finally, ComEd, in surrebuttal, supported a rate base of $6,951,006,000, but, under the Staff/ComEd joint recommendations, including ComEd's limited waivers,

agreed for purposes of this case to a rate base of $6,752,566,000. ComEd Ex. 40.0 Corr. at 3; ComEd Ex. 40.01, Sched. RB-1, columns (H) and (K). This is a reduction of $318,668,000 from its original proposal. However, if the Staff/ComEd joint recommendations are not adopted, then the ComEd requests the rate base of $6,951,006,000 be adopted.

Staff proposes a rate base of $6,645,499,000. Staff Init. Br., Appendix A at 4, line 23, column (d).

The AG proposes a series of adjustments to ComEd's test year rate base, including adjustments to net plant in service, accumulated depreciation, accumulated deferred income taxes, and customer advances for construction. AG/CUB Ex. 5.1. Based upon the testimony of AG/CUB witness Effron, record evidence and Commission practice, the AG proposes to ultimately reduce the Company's test year rate base by $869,954,000 to a total of $6,146,695,000. Id.

After the issuance of the ALJs' Proposed Order, Staff and ComEd took the positions described earlier in this Order and discussed further below.

A. The Stipulation

The Stipulation between Staff and ComEd was filed on the Commission's e-docket system on April 10, 2008, by Staff and was entitled "Stipulation Concerning Incorporation of Certain Adjustments from the Original Cost Audit and Resolution of Certain Revenue Requirement and Other Issues" ("Stipulation") and entered into the record as ComEd/Staff Joint Ex. 1.

1. Staff

The Stipulation pertains to certain adjustments that Staff witness Griffin proposed in his Direct Testimony (Staff Ex. 2.0 Corr.), and also incorporates in this case certain additional rate base reductions based on recommendations contained in the Delivery System Original Cost Audit Report ("Audit Report") issued by the Alliance Consulting Group ("ACG") dated December 21, 2007. Staff asserts that the proposed set of issue resolutions reflected in the Stipulation is a reasonable resolution of those issues for purposes of this case, results in adjustments that are beneficial to rate payers, and is supported by the record in this proceeding.

With respect to the Original Cost Audit ("OCA"), the Stipulation adopts certain adjustments proposed in the Audit Report that result in a reduction to plant in service totaling $116.635 million. A reduction to plant in service in the amount of $35.746 million is reflected on Staff Schedule 15.1. The remaining $80.889 million is reflected in ComEd's original filing in this rate case.

Staff explains that the $35.746 million reduction to plant in service consists of three items. The first item is a reduction to plant in service of $23.046 million (less accumulated depreciation and accumulated deferred income taxes) attributable to accounting for the costs of internal software alleged to be inconsistent with AICPA Statement of Position ("SOP") 98-1. ACG identified $23.046 million of costs that it asserts were improperly capitalized rather than expensed under SOP 98-1. While not agreeing that it has improperly capitalized these costs, ComEd has agreed in the

Stipulation to reduce its plant in service to reflect this adjustment. Staff witness Griffin testified that the $23.046 million proposed reduction of plant in service related to capitalizing certain costs that ACG asserts should have been expensed under SOP 98-1 is reasonable. Staff Ex. 15.0 Corr. at 4.

The second item is a reduction to plant in service of $10 million for other accounting policy changes or documentation issues identified by ACG but not attributable to any specific issue. Staff explains that ACG identified documentation that it contended was missing or inadequate with respect to certain items, as well as various accounting changes that it contended were not adequately supported. While not agreeing with ACG's assertions, ComEd has agreed to reduce its plant in service by $10 million in this case for other accounting policy changes or documentation issues identified by ACG but not attributable to any specific issue. Staff witness Griffin testified that the proposed $10 million reduction of plant in service for other accounting policy changes or documentation issues identified by ACG but not attributable to any specific issue is reasonable. *Id.* at 4-5.

The third item is a reduction of plant in service by $2.7 million related to the retroactive application by ComEd of AR-15 as to meters and transformers for the year 2003. FERC approved ComEd's request for the adoption of AR-15 principles relating to meters and transformers in July of 2003, and ACG asserted that this accounting change should have been implemented as of July 2003 rather than January 2003. While not agreeing with ACG's assertions as to when this change should have become effective, ComEd has agreed to reduce its plant in service by $2.7 million related to the asserted retroactive application by ComEd of AR-15 as to meters and transformers for the year 2003. Staff witness Griffin testified that the proposed $2.7 million reduction of plant in service related to the asserted retroactive application by ComEd of AR-15 as to meters and transformers for the year 2003 is reasonable. *Id.* at 5.

Staff disagrees with the argument that it would be unlawful for the Commission to adopt the proposed set of issue resolutions set forth in the Stipulation because it believes those resolutions are fully supported by the evidence in this proceeding and should be adopted on the merits. Further, Staff submits that the Stipulation has been misinterpreted or mischaracterized with respect to those matters for which it merely calls for Staff to withdraw certain of its proposals.

Staff notes that the Illinois Administrative Procedures Act provides that "[u]nless precluded by law, disposition may be made of any contested case by stipulation, agreed settlement, consent order, or default." 5 ILCS 100/10-25. Staff acknowledges that in *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 136 Ill.2d 192 (1989) ("*BPI I*") the Illinois Supreme Court held that "[i]n order for the Commission to dispose of a case by settlement, however, all of the parties and intervenors must agree to the settlement." *Id.* at 209 (citations omitted). Staff states, however, that the Illinois Supreme Court in *BPI I* also recognized that proposals which do not have unanimous support among the parties may nevertheless be adopted on the merits if the Commission finds such proposals are "supported by substantial evidence" and "would establish just and reasonable rates." *Id.* at 216-217.

Staff also asserts that certain parties also appear to read more into the Stipulation than in fact exists with respect to the withdrawal of Staff's accumulated depreciation adjustment. Staff does not dispute that the Stipulation contains a paragraph that makes acceptance of each agreed resolution contingent upon acceptance of all agreed resolutions. Staff-ComEd Joint Ex. 1, p. 4 (Section III, par. 1). However, with respect to accumulated depreciation, Staff observes that it and ComEd merely agreed that Staff would withdraw its proposed adjustment. Staff-ComEd Joint Ex. 1, p. 4 (Section II, par. 5, 2nd bullet). Staff notes that neither it nor ComEd stipulated to the rejection of any other party's proposal on accumulated depreciation, or to a specific accumulated depreciation amount. Staff states that while it may be that the AG's proposed accumulated depreciation adjustment will be rejected by the Commission given the Commission's recent rulings on this issue, Staff did not lock the Commission into rejecting the AG's position as a condition of accepting the proposed set of issue resolutions set forth in the Stipulation. Staff submits that the exclusion of third quarter pro forma adjustments is conditioned upon Staff withdrawing its proposed depreciation reserve adjustment, but it is not conditioned upon a rejection of other parties' depreciation reserve adjustments or a particular overall accumulated depreciation amount.

According to Staff, its testimony in this proceeding on these adjustments provide substantial record evidence for the Commission to approve the proposed set of issue resolutions contained in the Stipulation between Staff and ComEd. In addition, Staff notes that ComEd has offered evidence on these issues as well. Therefore, Staff concludes, the arguments calling for rejection of the resolutions proposed in the Stipulation should be denied.

Staff states that to the extent that parties are arguing that the approval of the resolutions set forth in the Stipulation would somehow pre-determine the outcome of the Audit Approval Docket (Docket 08-0312), they have misread or misinterpreted the Stipulation. With respect to the Audit Approval Docket, the Stipulation merely provides that Staff "will not advocate that any conclusions or recommendations identified in the OCA Report should be adopted or ordered by the Commission in the Audit Docket or that any adjustments identified in the Audit Report should be made except as set forth in this Stipulation." Staff-ComEd Joint Ex. 1 at 2-3 (Section I, par. 6). Staff asserts that this language in no way precludes the Commission from considering or ruling on other parties' positions or arguments in the Audit Approval Docket or elsewhere.

2. AG

The Stipulation resolves certain revenue requirement issues as well as adjustments related to the OCA that is the subject of a separate Commission proceeding. The AG takes issue with the fact that although the audit was not presented as evidence in this case, ComEd and Staff nevertheless relied upon their respective evaluations of the OCA Report, as well as the evidence submitted by other parties and the responses to discovery in this docket, in arriving at their decision to enter into the Stipulation. The AG argues that the Stipulation must be rejected because the Commission has no authority to approve it and, further, it would lead to unjust and unreasonable rates for ratepayers.

The AG argues that the Commission cannot adopt the Stipulation's proposed resolution of issues because to do so would be unlawful, under principles established in *BPI I*. In its analysis of the relevant legal standard, the AG states that in *BPI I*, the Illinois Supreme Court established rules for Commission review of "settlements" proposed by fewer than all parties to a Commission investigation or docket. *BPI I*, 136 Ill.2d at 216-218. The AG cites to the *BPI I* standard that a partial settlement can be adopted only when it is supported by substantial record evidence to ensure that the Commission does not make unsupported decisions on matters within its authority. *Id.*

Applying the *BPI I* standard to the facts of this case, the AG argues that the Stipulation's terms are not supported by substantial evidence because (1) they are premised on an analysis of an audit that is not in the record, (2) other parties have not reviewed the audit as part of this proceeding, and (3) the Commission has specifically stated that the audit will be reviewed in a separate formal proceeding that it has only just commenced. The AG points out that no discovery and no testimony have been prepared in connection with the audit in this case or in Docket 08-0312, and further argues that the Commission cannot lawfully rule on the merits of the Stipulation, and in fact, must reject its proposals in their entirety. Additionally, the AG states that even if the Commission were able to consider the Stipulation at all, which it is not, it would still have to reject its terms because the Commission cannot make a decision on issues in this case based on evidence not in the record, but that is part of another docket, citing to 220 ILCS 5/10-103. The AG concludes that the Commission is obliged to reject the Stipulation in its entirety due to the absence of the information underlying the Stipulation from the record, and the absence of any evidence supporting the specific proposals contained in that agreement from the record.

3. ComEd

In its Reply Brief, ComEd observes that the AG is alone among the Intervenors in asserting that the Commission does not have the authority to approve the Stipulation. ComEd did not ask the Commission to "approve" the Stipulation. Instead, ComEd and Staff jointly ask the Commission to make various findings on the merits, each of which is independently supported by substantial evidence in the record. That evidence includes not only testimony and documentation submitted by ComEd, but testimony from Staff as well, and ComEd's limited waivers. There is no legal impediment to the Commission's incorporating in the final Order in this Docket the Staff/ComEd joint recommendations supported by the evidence and ComEd's limited waivers simply because they are also reflected in and recommended by the Stipulation. ComEd also showed that if the AG's arguments regarding the Stipulation had merit, then that would only result in rejecting some or all of ComEd's limited waivers in the Staff/ComEd joint recommendations, increasing rate base and operating expenses and, thus, the revenue requirement and the necessary rate increase.

Specifically, ComEd states that it had expressed a willingness, if the Commission agrees with and adopts these Staff/ComEd joint recommendations based on the evidence in the record, including ComEd's limited waivers, to reduce its requested rate base and operating expenses, and thus its revenue requirement, below the level supported by the evidence. That conditional concession would reduce ComEd's rate

increase to $314.451 million, $30.953 million below its proven actual revenue deficiency of $345.404 million.

ComEd argues that instead, the AG pointed to "settlement" cases that do not apply to the Staff/ComEd joint recommendations and that would not prohibit the action ComEd seeks even if the recommendations were deemed a partial settlement. The AG argued that the Illinois Supreme Court considered the issue of "partial settlements" (settlements entered into by some but not all of the parties) in *BPI I*. What is prohibited by *BPI I* is imposing a result on non-consenting parties by reason of a partial settlement that is not supported by the evidence in the record. Here, ComEd and Staff do not urge the Commission to accept their joint recommendations because they are agreed to, but rather because they are supported by the evidence in the record, including ComEd's limited waivers. The fact that both Staff and ComEd have agreed to support the same recommendations no more makes this a "settlement" case than would the concurrence of the members of REACT, IIEC, or RESA – or, for that matter, the AG and CUB – in support of the same issue resolutions. Simply because the Stipulation was placed in the record to make their positions clear does not mean that ComEd and Staff ask for approval of a settlement.

ComEd asserts that it has proved its rate base and operating expenses in amounts exceeding the levels provided for in the Stipulation. For example, ComEd justified the inclusion of pro forma plant additions through the third quarter of 2008, consistent with the Commission's rules. The Stipulation itself recites some of the record evidence upon which it is based. The evidence, however, is not limited to that expressly cited in the Stipulation itself. Under the Stipulation, however, ComEd agrees to make a limited waiver of its rights, *i.e.*, to accept in this case inclusion in rate base of only two quarters of pro forma capital additions in 2008, less than that to which it would be entitled under the evidence and the law. Because a greater amount of capital additions is fully supported by the record, the capital additions that are the subject of the Stipulation are also supported by the record.

The Stipulation's references to the OCA and the Audit Report do not support the AG's position, but rather the opposite. The Stipulation reflects reductions to ComEd's rate base and operating expenses related to the audit that would not be possible at this stage of the case without the concessions that ComEd made under the Stipulation. No proposed component of, or increase in, ComEd's rate base or revenue requirement is based on the Audit Report, and that to say, as the AG did, that the Stipulation is "premised on an analysis of an audit that is not in the record" is misleading and incorrect. *See* AG Init. Br. at 4. ComEd and, presumably, Staff considered their own respective evaluations of the Audit Report in arriving at the Stipulation. However, they did not ask the Commission to act based on those evaluations, or on the results of the Audit, or the Audit Report. Nothing in the Stipulation or in any recommendation that Staff and ComEd made in this Docket prevents any other party from litigating in the OCA proceeding Docket 08-0312 any of the issues relating to the Audit or discussed in the Audit Report. Any resolution of those litigated issues can be incorporated into

ComEd's next rate case. That is precisely what the Commission envisioned in its Interim Order in Docket 05-0597 that initiated the audit. See Docket 05-0597, Interim Order at 2-4 (April 5, 2006).

4. Commission Analysis and Conclusion

The Commission observes that historically, it has welcomed consensus recommendations arrived at by groups of litigants, and they are presented routinely, notably Docket 99-0017, Docket 01-0423; Dockets 01-0707, 02-0727, 03-0705, 04-0683, 01-0706,02-0726,03-0704 and 04-0682. Such consensus recommendations are neither illegal, nor invitations to base a decision on anything other than on the record. It is, rather, for the Commission to determine if the record supports the jointly supported recommendations. In Docket 01-0707, the Commission was presented with a non-unanimous settlement agreement proffered by the AG and The Peoples Gas Light and Coke Company that involved eight separate proceedings. In reviewing the legal sufficiency of such a settlement we noted in our Order that the Illinois Supreme Court in *BPI* addressed the standard that must be employed when the Commission entertains approval of settlement agreements and adoption of proposed settlement agreements. Under *BPI,* the Commission may approve a settlement agreement as a settlement agreement if there is unanimous support for it. *Id.* at 217-218. However, if a settlement agreement lacks unanimous support, for the Commission to consider and adopt the proposed agreement as an appropriate resolution on the merits, three conditions must be met: (1) the provisions of the settlement agreement must be within the Commission's authority to impose; (2) the provisions must not contravene the Act; and (3) substantial evidence must exist in the record to independently support the provisions of the proposed settlement. *Id.* It may be observed that the requirements expressed by the Illinois Supreme Court in *BPI* concerning the Commission's adoption of a non-unanimous settlement proposal as a resolution on the merits of a case are similar in substance to the standards found in section 10-201 of the Act that apply generally to the judicial review of Commission orders and decisions.

In this instance, of key importance is that neither Commission Staff nor the Company are requesting that the Commission enter an Order approving the agreement or Stipulation that they have reached regarding resolution of various issues in this matter. Instead, the Commission, as we are lawfully mandated, will conduct a *BPI* analysis and base our determinations and ultimate conclusions on the record evidence. Hence, the Stipulation is irrelevant to the Commission for purposes of our determinations in this matter. Accordingly, the Stipulation will be treated as merely another proposed resolution for the various contested issues addressed in this proceeding that must be considered based on the record evidence adduced in this docket. Moreover, we note that any decision in this docket will have no bearing on the Commission's decision in the OCA proceeding Docket 08-0312. Indeed, all parties in that proceeding may present their respective positions that are germane to the issues for review in that Docket. Because, as discussed elsewhere in this Order, we have found that each of the individual relevant issues are supported by the record and should be approved, we note that the conditions under which ComEd agreed to the limited waivers it proposed have been met and, thus, we accept ComEd's waivers.

Accordingly, the Commission accepts the aggregate $35.746 million of rate base reductions referenced above.

B. Uncontested Issues

1. Plant

a) Major Capital Additions (Schedule F-4 Projects)

As required by the Commission's rules 83 Ill. Adm. Code §§285.6100 and 286.20, ComEd provides detailed information about its five largest additions to rate base. No party contested including these five projects in rate base.

b) Capitalized Incentive Compensation Not Allowed in 2005 Rate Case

Staff witness Hathhorn proposes an adjustment to decrease the Company's rate base and operating expenses to disallow incentive compensation costs capitalized but disallowed in Docket 05-0597. Subject to its appeal of the Commission's Order in Docket 05-0597, ComEd did not contest this component of Staff's incentive compensation adjustment. The Commission finds Staff's adjustment to be reasonable.

c) Capitalized Information Technology Costs

In direct testimony, Staff witness Hathhorn proposes an adjustment to ComEd's rate base and operating expenses to adjust the test year level of information technology costs to a normal level. Ms. Hathhorn subsequently withdrew this proposal and it is not adopted.

d) Merger Costs

Staff witness Hathhorn proposes an adjustment to decrease the Company's rate base to disallow capitalized costs related to the defunct merger of Exelon Corporation ("Exelon") with Public Service Enterprise Group ("PSEG"). ComEd does not contest this component of Staff's merger costs adjustment in its rebuttal testimony, subject to its correction to disallow only jurisdictional costs. Staff agrees with this correction. We agree that an adjustment of $29,702 is reasonable and it is adopted.

e) Contested Staff-Proposed Adjustments That Are Uncontested If the Set of Resolutions Reflected in the Stipulation Is Approved

(1) ComEd

Staff originally recommended that ComEd change the method it uses to allocate the costs of common facilities at certain substations between transmission and distribution. Staff Ex. 2.0 Corr. at 22-25. In addition, Staff recommended the following four adjustments to ComEd's rate base: (1) $14,951,000 primarily related to ComEd's capitalization policy for software developed or obtained for internal use (*id.* at 8-11); (2) $89,457,000 related to ComEd's capitalization policy for cable replacements or repairs (referred to as cable faults) (*id.* at 14-16); (3) $901,000 related to ComEd's method of allocating departmental overheads (*id.* at 11-12); and (4) $1,556,000 related to ComEd's accounting treatment of the stores clearing account (*id.* at 12-13).

ComEd, in rebuttal, responded to Staff's positions and proposals, showing not only that those proposals lacked merit, but also that, if adopted, they would require offsetting increases to rate base and operating expenses that would result in a significantly increased revenue requirement. ComEd Ex. 26.0 at 6-22; ComEd Ex. 27.0 at 6-22; ComEd Ex. 25.0 Corr. at 19-21, 31 37.

Staff later withdrew those proposals, pursuant to the Stipulation. Staff-ComEd Joint Ex. 1 at 4; Staff Ex. 15.0 Corr. at 9-12. No other party supported those proposals.

(2) Staff

Staff explains that there are four adjustments that were proposed by Mr. Griffin in his Direct Testimony, Staff Ex. 2.0 Corr., that were contested but were withdrawn by Mr. Griffin in his Rebuttal Testimony subject to acceptance of the proposed set of issue resolutions set forth in the Stipulation. In addition, Mr. Griffin had a recommendation that common facilities at dual-substations be allocated by a different method. As part of the Stipulation, Mr. Griffin agrees to withdraw that recommendation given that the different allocation methods would simply shift costs between those recovered in transmission rates and those recovered in distribution rates.

The first adjustment to be withdrawn, Adjustments to Software Developed or Obtained for Internal Use, removes the impact of ComEd reducing the threshold for capitalization of certain software from $10,000,000 to $100,000. Staff Ex. 2.0 Corr. at 8-11, Schedule 2.3. ComEd has agreed to provide to the Manager of the Commission's Accounting Department notice of ComEd's intent to change its capitalization policy where such change is expected to result in an annual change in amounts capitalized of at least $10 million. The provision of this notice by ComEd will not constitute approval of, consent to, or waiver of challenges or objections to such changes by Staff. ComEd has also agreed to enter into discussions with Staff with the goal of explaining to Staff its current capitalization policy with respect to internal software, departmental overheads and the Property Unit Catalog (including, with respect to the Property Unit Catalog, time in the field). Staff witness Griffin testified that this proposal is reasonable. Staff Ex. 15.0 Corr. at 9-10.

The second proposed adjustment to be withdrawn, Adjustments to Departmental Overheads, removes the impact of including contract labor costs in the base for loading department overheads. Staff Ex. 2.0 Corr. at 11-12, Schedule 2.4. Although ComEd has not provided evidence that the same level of supervision is needed when using contractor labor as when using internal labor, Staff states it is reasonable to assume that some supervision by ComEd is needed with respect to contractor labor in a manner similar to its supervision of internal labor. Staff Ex. 15.0 Corr. at 10. Therefore, for purposes of this case, Staff finds it reasonable to withdraw this adjustment. Staff notes that ComEd has agreed to conduct a study of its policy of including contractor labor costs in the base for loading of departmental overheads and provide a report regarding the results of such study to the Manager of the Accounting Department within 90 days of a final order in this docket. Depending on the result of that study, Staff or any other party in a subsequent rate case could raise the issue if appropriate. *Id.*

The third adjustment to be withdrawn, Adjustments to Stores Clearing Account, reverses ComEd's accounting entry to clear the stores clearing account to zero at December 31, 2006. Staff Ex. 2.0 Corr. at 13. Mr. Griffin originally testified that the stores clearing account should not be set to zero because there are some stores clearing costs associated with the Materials and Supplies inventory included in rate base. *Id.* In their rebuttal testimony ComEd witnesses Houtsma and Frank pointed out that prior to ComEd's change in its accounting policy, the Commission allowed rate base treatment by including the stores balance at year end in the rate base as part of materials and supplies inventory. Mr. Griffin, therefore, agreed that some rate base treatment should be allowed and found it reasonable to withdraw his proposed adjustment. Mr. Griffin also noted that this change in accounting policy can be reviewed in the future if appropriate. Staff Ex. 15.0 Corr. at 11.

The fourth adjustment to be withdrawn, Changes to the Property Unit Catalog, reverses the capitalization of certain costs that would not have been capitalized but for changes ComEd made to its property unit catalog in 2002. Staff Ex. 2.0 Corr. at 14-15. ComEd has agreed to meet with Staff to explain its current capitalization policy with respect to the property unit catalog. In Staff's opinion, this policy needs to be based on reasons other than consistency with affiliates. Staff states that these meetings will provide an appropriate and productive forum for Staff to assess the basis for the current property unit catalog. If there is any adjustment required, it can be done on a going forward basis. Staff witness Griffin testified that this proposal is reasonable. Staff Ex. 15.0 Corr. at 11.

For all the reasons stated above, Staff asserts that it is reasonable and in the best interest of rate payers that the adjustments made by Mr. Griffin in his direct testimony and calculated on his Schedules 2.3, 2.4, 2.5, and 2.6 be withdrawn and the recommendation regarding common facilities be withdrawn as well if the set of issue resolutions reflected in the Stipulation are accepted by the Commission.

(3) Commission Analysis and Conclusion

Although these issues are addressed in the joint recommendations proposed by Staff and ComEd, we observe that Staff's original adjustments would result in an increased revenue requirement. Accordingly, Staff's adjustments, as proposed by Mr. Griffin in his Direct Testimony are denied; however we adopt Staff's recommended adjustments as outlined above and supported by the record as stated in Section C(1) below. We note that these changes to accounting policy can be reviewed at a later date if necessary. In order to facilitate Staff's review of ComEd's accounts, we direct the Company to:

- provide to the Manager of the Commission's Accounting Department notice of ComEd's intent to change its capitalization policy where such change is expected to result in an annual change in amounts capitalized of at least $10 million;
- conduct a study of its policy of including contractor labor costs in the base for loading of departmental overheads and provide a report regarding the results of such study to the Manager of the Accounting Department within 90 days of a final

order in this docket. Depending on the result of that study, Staff or any other party in a subsequent rate case can raise the issue if appropriate;

- meet with Staff to explain its current capitalization policy with respect to the property unit catalog.

2. Construction Work in Progress ("CWIP")

In rebuttal testimony, ComEd proposes that $33,682,000 of CWIP not accruing AFUDC should be included in rate base. This amount is uncontested and, therefore, is adopted.

3. Materials and Supplies

ComEd witness Williams accepts Staff's proposal to use the average of 2007 inventory levels, $33,094,000. This proposal is reasonable and reflects the Company's approximate inventory levels going forward for the near future. Accordingly, it is adopted.

4. Other Post-Employment Benefits ("OPEB")

ComEd agrees to Mr. Effron's proposal to remove $7,504,000 from ComEd's rate base. Accordingly, this issue has been resolved and is approved by the Commission.

C. Contested Issues

1. Plant

a) Pro Forma Capital Additions

(1) Propriety of Additions

(a) ComEd

ComEd asserts that it identified and supported plant additions made to provide delivery services that were placed in service in 2007 or are reasonably expected to be placed in service by the end of the third quarter of 2008 and are serving retail customers now or will be serving retail customers within a year after filing its proposed tariffs. ComEd Ex. 4.0 2nd Corr. at 37-41; ComEd Ex. 5.0 Corr. at 16-46, 51-52; ComEd Ex. 7.0 Corr. at 35; ComEd Ex. 7.1, Sched. B-2.1; ComEd Ex. 7.2, Work Papers WPB 2.1a, WPB-2.1b. ComEd argues that this delivery services plant is appropriately included in rate base for purposes of the revenue requirement under numerous prior Commission decisions and 83 Ill. Adm. Code § 287.40. According to ComEd, the evidence shows that the pro forma plant additions will occur or are reasonably certain to occur within 12 months of the filing, and are known, measurable, and determinable. Further, the evidence shows that ComEd applied the necessary cost controls and management techniques to ensure that the investments were and will be made prudently and at reasonable cost. E.g., ComEd Ex. 5.0 Corr. at 9-13; ComEd Ex. 4.0 2nd Corr. at 41-42.

ComEd asserts that it refuted the AG's proposal that the Commission should determine ComEd's pro forma capital additions using a figure extrapolated from the dates of completion and costs of different additions in another time period. No reason exists to extrapolate from a previous year to make an estimate of the capital additions for the first two quarters of 2008. ComEd maintains that it has complied with Section

287.40, which requires that adjustments to pro forma estimates be "individually identified and supported in the direct testimony of the utility." Thus, ComEd argues that its proof of capital additions provides the best basis for the Commission to determine ComEd's pro forma capital additions.

According to ComEd, no serious quarrel exists with its pro forma capital additions through June 30, 2008. First, no party argues that any of the plant additions were imprudently undertaken, unreasonable in amount, or not used and useful. These additions include projects to establish service to new customers, "summer critical" projects, corrective and preventative maintenance projects, projects to enhance system performance, and others. Further, having ensured that the investments were prudently made and reasonable in cost, ComEd maintains that it has shown that its capital additions satisfy the requirements applicable to all facilities included in rate base, and the record contains no contrary evidence.

Second, ComEd maintains that no genuine issue exists as to whether the investments are known and measurable. ComEd present detailed documentation quantifying the costs of these projects. ComEd Ex. 21.0 Corr. at 23-67; ComEd Ex. 24.0 at 9-60; ComEd Ex. 25.0 Corr. at 10; ComEd Ex. 25.01, Revised Schedule B-2; ComEd Ex. 25.02, Work Papers WPB 2.1, WPB 2.1b. Moreover, ComEd claims that its evidence shows that ComEd's bottom-up analysis totaling the cost of actual projects was superior to the AG's use of average investments from other years. E.g., ComEd Ex. 21.0 Corr. at 68; ComEd Ex. 25.0 Corr. at 16-17.

ComEd notes that under the Stipulation, ComEd agrees to a limited waiver providing that its pro forma capital additions would extend only through June 30, 2008, less than the twelve months post-filing permitted, and would be subject to final updating as provided in the Stipulation. ComEd's pro forma capital additions through June 30, 2008, represent known and measurable capital additions for 2007 and the first two quarters of 2008 and should be included in ComEd's rate base.

Finally, ComEd argues that the record establishes that at least $1,334,607,000 in additions to delivery services plant occurred or will occur through the end of the second quarter of 2008 and should be added to rate base as part of ComEd's pro forma adjustments for post-test year capital additions. *See* ComEd Ex. 40.0 Corr. at 6. If the Commission decides to reject the proposed set of issue resolutions in the Stipulation, including ComEd's limited waiver here, ComEd's proposed pro forma adjustments through the end of the third quarter of 2008, as updated in ComEd's rebuttal and supported by the evidence in the record should be approved.

(b) Staff

In his Direct Testimony, Staff witness Griffin proposes the elimination of ComEd's pro forma plant additions for the first three quarters of 2008 because the pro forma additions were not appropriate under the Commission's test year rules for a historical test year which require the pro forma additions to be "reasonably certain to occur" and "determinable." 83 Ill. Adm. Code 287.40. As part of the Stipulation, Staff and ComEd jointly propose to reduce the proposed pro forma additions by $171,755,000. The Stipulation also provides that ComEd will file a late-filed exhibit or compliance filing

showing actual and projected pro forma additions for the six months ended June 30, 2008. If the actual pro forma additions for that period are less than projected, the rate base will be reduced accordingly. Staff views this adjustment as reflecting a reasonable amount for those pro forma plant additions that will be known and measurable under the Commission's test year rules for historical test years. 83 Ill. Adm. Code 287.20 and 83 Ill. Adm. Code 287.40.

Staff believes that this adjustment is reasonable for three reasons: First, Mr. Griffin indicated that he would consider additional information provided after the filing of his direct testimony (Staff Ex. 2.0 Corr. at 8) which he has done. Mr. Griffin considered ComEd's response to Staff Data Request TLG 4.03, which indicated that Capacity Expansion projects are summer critical and must be closed by June 1, 2008. These projects are facility location projects which are required to be closed by specific times by a government entity. The response also indicated that the Capacity Expansion projects are considered short term CWIP that do not accrue AFUDC and that these projects have contracts with completion dates and costs. Staff Ex. 15.0 Corr. at 6-7.

Second, the rebuttal testimony of ComEd witness Donnelly states that $114.1 million of distribution projects had already been placed into service as of February 29, 2008, and that many of the remaining projects are summer critical. *Id.* at 7.

Third, ComEd agrees, as reflected in the Stipulation, that to the extent that actual pro forma capital additions actually placed in service during the first two quarters of 2008 (on a combined basis) are less than projected pro forma capital additions for the first two quarters of 2008 of $540.40 million (on a combined basis), then plant in service shall be reduced by an additional amount equal to the difference between those figures. Mr. Griffin indicated in his direct testimony that investments that have actually been made for projects actually in service satisfy the known and measurable standard.

Staff presents the effect on Plant in Service, Accumulated Depreciation, Accrued Income Taxes and Depreciation Expense of the adjustment to Plant in Service on Staff Ex. 15.2. Staff further states that should the Commission not accept the proposed set of issue resolutions set forth in the Stipulation, then the Commission should only include the pro forma additions shown in ComEd's late filed exhibit or a compliance filing which will show the amount of pro forma additions to plant in service closed to the books at June 30, 2008.

(c) AG

Regarding ComEd's projection of additions to plant in service for March through September of 2008, the AG argues that they should be based on its actual historic experience and states that pro forma adjustments to historical test years are made where the changes are "reasonably certain to occur" in determinable amounts within twelve months of the tariff filings. 83 Ill. Admin. Code 287.40.

ComEd projects additions of $598.0 million, or $85.4 million per month, over the seven months from March 1, 2008, through September 30, 2008. ComEd Ex. 21.0 at 2. This same exhibit shows the actual additions to jurisdictional plant in service in 2007 were $767.8 million, which translates into approximately $64.0 million of additions per month. *Id.* The actual plant additions in the first two months of 2008 were $114.1

million, approximately $57.0 million per month. *Id.* Thus, the actual average of plant additions has been well below $85.4 million per month. *Id.* The AG argues that ComEd's projections cannot be considered "reasonably certain" to occur and that, despite putting forth what the company calls "an unprecedented quantity of data" regarding the proposed capital additions for the first three quarters of 2008, ComEd Ex. 36.0, the Company was not able to show at any time how it would finance those proposed additions. Tr. at 1067; AG Cross Ex. 9.0.

AG/CUB witness Effron proposes modifying ComEd's projection of additions to plant in service based on its actual experience through December 31, 2007. The AG states that while Mr. Effron's approach may appear simple, the result is a more accurate reflection of the Company's actual historical experience. Mr. Effron's proposal modifies the Company's forecast so that it is consistent with the Company's actual experience, resulting in a decrease of $49,108,000 to the forecast of net additions to distribution plant in service, and a decrease of $8,264,000 to the Company's forecast of net additions to jurisdictional general and intangible plant in service. AG/CUB Ex. 5.0 at 4.

(d) Commission Analysis and Conclusion

See decision below, Impact on Test Year Rate Base, Accumulated Provisions for Depreciation and Amortization.

(2) Impact on Test Year Rate Base

(a) Accumulated Provisions for Depreciation and Amortization

(i) ComEd

ComEd asserts that it correctly calculated the Depreciation Reserve using the same methodology that it employed, and that the Commission approved, in ComEd's 2005 and 2001 rate cases. ComEd's calculations start with the jurisdictional figure for the reserve as of the end of the test year, December 31, 2006, and then made the adjustments needed to reflect the impacts of its proposed adjustments to plant, including its pro forma adjustments for post-test year capital additions. ComEd Ex. 7.0 Corr. at 18, 34-36; ComEd Ex. 7.1, Sched. B-1 at 1, l.8, column (D), Sched. B-2 at 1, columns (B) and (C), Sched. B-2.1; ComEd Ex. 7.2, Work Papers WPB-2.1a, WPB-2.1b.

AG/CUB and IIEC seek to reduce rate base by adding seven quarters of post test year depreciation expenses for test year plant to the Depreciation Reserve, in the amount of $693,553,000 under the AG/CUB proposal, and in the amount of $566,832,000 under the IIEC proposal. AG/CUB Ex. 5.1, Sched. B 1.1 at 4; IIEC Ex. 2.21 at 1.

As the Commission previously found, AG/CUB's and IIEC's proposals are contrary to the Commission's rules and basic ratemaking principles. As the Commission found, their proposals: (1) seek improperly to change the test year as to the Depreciation Reserve for test year plant; (2) disregard that the pro forma adjustments rule provides for "changes ... in plant investment...", not in net plant (or rate base), while offering a host of theories, none of which is right, to support interpreting the

rule as if it said "net plant"; and (3) disregard that the rule prohibits adjustments based on "[a]ttrition or inflation" (the depreciation on test year plant in their proposal being attrition over time). 83 Ill. Adm. Code §§ 287.20, 287.40; *see also, e.g.*, ComEd Ex. 25.0 Corr. at 23, 26; ComEd Ex. 40.0 Corr. at 12-20.

The Commission, in three other cases, rejected the same proposal by the AG that AG/CUB and the IIEC renew in this case. First, in the 2005 ComEd rate case, the Commission held: "The AG's proposed adjustment does not correlate to any pro forma 2005 capital additions or any plant adjustment proposed by any of the parties. Instead, the AG's proposal merely takes one part of the rate base and moves it one additional year into the future. …" Docket 05-0597, Final Order at 15. In so holding, the Commission rejected as inapplicable the AG's citations to the same Orders that AG/CUB and IIEC rely on in the instant case.

Second, ComEd states the Commission also rejected the same proposal in ComEd's 2001 rate case. Docket 01-0423, Interim Order at 41-44, *ruling carried forward to* Final Order (March 28, 2003). Third, in February 2008, the Commission again rejected the same proposal in its Order in the 2007 Peoples Gas/North Shore Gas rate cases Docket 07-0241/07-0242. AG/CUB and IIEC claimed that the past proposals rejected as inapplicable by the Commission in its Orders in the 2005 ComEd rate case and the 2007 Peoples Gas/North Shore rate cases somehow supported them, that their proposals were consistent with the Commission's pro forma adjustment rule, and that their proposals were necessary to avoid an inflated rate base. ComEd claims that all of those claims are wrong. The past Orders and the rules support only one outcome, which, according to ComEd, is to again reject the proposal as contrary to those Orders and violative of the test year rule and principles and the pro forma adjustments rule. The Orders cited by AG/CUB and IIEC in support of their proposals only deal with cases where the utility's net plant was essentially static or declining over time, whereas it is undisputed that ComEd's net plant has a trend of consistently increasing by hundreds of millions of dollars per year, and that the pace of investment has increased since the test year. ComEd also argues that AG/CUB's and IIEC's claims of an inflated rate base are wrong. Even if the Commission approved the reduced rate increase of $314.451 million and rejected the AG/CUB and IIEC proposals here, ComEd still would under recover its costs of service. Indeed, if post test year operating expenses were adopted on the same basis as AG/CUB and IIEC propose to update test year plant, the result would be a higher revenue requirement.

The Commission's ruling in its February 2008 Order in Peoples Gas/North Shore rate cases against the AG and CUB on this issue was intended to "bring[] certainty to a situation and settle[] expectations" in an effort to avoid "arbitrary and capricious action[s]" in cases where the relevant facts have not changed. Docket 07-0241/07-0242, Order at 16.

(ii) CG

The Commercial Group supports the adjustments of AG/CUB.

(iii) AG

The AG's argument can be split into two sections: (1) net plant, not gross plant, is the determining factor in calculating total utility rate base and (2) all offsetting adjustments from the revenue requirement test year and from post-test year period should be included in the calculating rates to comply with the "matching" and "representative" requirements of the test-year principle.

Net plant, not gross plant, is the determining factor in calculating total utility rate base. The AG states that the Commission's rules on pro forma adjustments to historical test years and on the calculation of rate base require that net plant, not gross plant, is the determining factor in calculating total utility rate base. The AG cites the Commission rule on the submission of pro forma adjustments.

The AG then argues that the fact that pro forma adjustments may be made only for all "known and measurable changes" in test year operating results, and not only for selected changes, clarifies the rule's use of the term "plant investment" as net plant. Furthermore, the admonition in the language of the rule, providing that these adjustments "shall reflect changes affecting ratepayers in plant investment", points to the ratemaking process -- and its necessary reliance on net plant, not gross plant, to calculate rates -- as the proper interpretive tool. *Verizon Communications, Inc. v. F.C.C.*, 535 U.S. 467, 486, 526, 122 S.Ct. 1646, 1680 (2002) (stating that rates under traditional public utility model are calculated on rate base subject to deductions for accrued depreciation).

In interpreting the rule further, the AG states that the rule not only specifies the precise manner in which any pro forma adjustments to jurisdictional rate base must be recorded, but it significantly requires that pro forma adjustments be prepared in the same manner as is required under the Commission's standard information requirements filings. The AG cites to 83 Ill. Admin. Code 285.2005, "Schedule B-1, Jurisdictional Rate Base Summary by ICC Account", which specifies that a utility's schedule of rate base components is to include: (1) Gross utility plant in service at original cost; (2) Reserve for accumulated depreciation; (3) Net utility plant in service; (4) Other individual items comprising rate base separately listed, such as working capital, construction work in progress included in rate base, customer advances and accumulated deferred income taxes; and (5) Total rate base. Based on these rules, the AG argues that the Commission's rules repeatedly echo the theme that the ratemaking process requires rate base information that reflects net plant investment.

AG/CUB witness Effron made adjustments for accumulated depreciation to comply with the test-year rule "matching" and "representative" principles, which are required by test-year principles to prevent the mismatching of revenues and expenses that are part of the revenue requirement formula. *Business and Professional People for the Public Interest vs. Illinois Commerce Comm'n*, 146 Ill.2d 175, 238 and 242 (1991) ("*BPI II*"). The AG claims that by adjusting for the actual accumulated depreciation reserve associated with capital additions made in the test year, Mr. Effron's adjustments match elements that raise the revenue requirement with elements that reduce the

revenue requirement in the same time period. Furthermore, by making similar adjustments to the company's pro forma additions to utility plant, Mr. Effron's depreciation adjustments reflect the net change to ComEd's cost of service that is expected will be the result of post test year plant additions, thereby resulting in rates more representative of costs that will exist when the new rates go into effect.

The Commission has previously adopted pro forma adjustments to the reserve for accumulated depreciation precisely because those adjustments matched the period of pro forma plant additions. Illinois Power Company, Proposed general increase in electric rates, Docket 01-0432, Order at 20-21 (March 28, 2002). The Commission also recognized the need to reflect the utility's costs at the time new rates are implemented. Union Electric Company, Proposed general increase in natural gas rates, Docket 03-0009, Order at 9-10 (October 22, 2003). The Commission ordered that the company be permitted to record pro forma capital additions in rate base "only to the extent that they exceed increased accumulated depreciation," accounting the Commission reasoned "…more accurately matches the costs and revenues that may be expected for the period during which the rates are in place." *Id.*

AG/CUB witness Effron's proposed adjustments to ComEd's rate base include a provision for accumulated depreciation to account for that portion of utility plant investment that has been recovered from ratepayers. Tr. at 859-860. According to Effron's calculations, the accuracy of which has not been challenged by the Company, that return of investment to ComEd amounts to $566,150,000. AG/CUB Ex. 5.1, Sched. B.

Mr. Effron's changes in the reserve for accumulated depreciation reflect the Company's actual changes in the balance for that account for the test year and through December 31, 2007, plus an adjustment to reflect the pro forma balance of accumulated depreciation associated with the company's pro forma capital additions for the period January 1, 2008 through September 30, 2008. *Id.* This methodology reflects the actual growth in depreciation reserve for the test year and for growth taking place in 2008 as the post-test year plant additions in 2008 take place. *Id.*

(iv) IIEC

IIEC notes ComEd has chosen a 2006 historical test year as the proposed basis for setting rates in this case. IIEC also observes that under the Commission's test year rules and governing case law, a utility's costs and revenues are matched over a consistent time period -- the test year. *See* 83 Ill. Adm. Code Part 287, Part 285. "The purpose of the test year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year." *BPI II* at 238.

According to IIEC, exceptions to those restraints are governed by Section 287.40 (Pro Forma Adjustments) of the Commission's rules. 83 Ill. Adm. Code 287.40. IIEC argues that the relevant language permits pro forma adjustments for all known and measurable "changes affecting the ratepayers in plant investment, operating revenues, expenses, and cost of capital." IIEC notes that proper adjustments under Section 287.40 are consistent with the revenue requirement formula [Revenue Requirement =

(Operating Expense) + (Rate of Return) x (Rate Base)] and with the fundamental test year requirement to match rate setting data over a consistent time period. *BPI II* at 238. IIEC also cites the Commission's determination that pro forma adjustments should reflect revenues and costs during the period rates are in effect. Re Central Illinois Public Service Company (AmerenCIPS) et al, Dockets 02-0798,03-0008, 03-0009 (Cons.) ("AIU Cases"), Final Order at 10-11 (Oct. 23, 2003).

In the context of these ratemaking norms, IIEC says ComEd proposed to recognize almost $1.5 billion in post-test year additions to Gross Plant as a basis for setting rates, even though the investment on which a utility is permitted to earn grows only if and to the extent that its Net Plant increases. ComEd's rate base and customer rates are not changed dollar-for-dollar by gross plant additions. According to IIEC, the Commission must recognize both post-test year increases and post-test year decreases to ComEd's test year rate base. IIEC contends that, by increasing gross plant while ignoring the offsetting changes in accumulated depreciation, ComEd overstated its rate base by $654 million. It is IIEC's position that this erroneous rate base adjustment inflated ComEd's revenue requirement by approximately $93.6 million.

IIEC recommends that the one-sided adjustment proposed by ComEd be rejected for at least three reasons. First, ComEd's proposal is inconsistent with any reasonable reading of Section 287.40, which cannot reject customary accounting conventions on the calculation of net plant and rate base. IIEC says Mr. Griffin of Staff confirmed that calculating net plant without appropriate recognition of accumulated depreciation is an anomaly -- unique to a particular interpretation of pro forma plant adjustments. In no other context would net plant be calculated without considering accumulated depreciation. IIEC also points out that both Staff and ComEd have taken proper account of accumulated depreciation in computing this critical ratemaking quantity in every other context.

Second, IIEC argues, the result of ComEd's proposed adjustment is not representative of the matched costs and revenues -- the heart of the Commission's test year and pro forma adjustment rules -- that will exist when rates set in this case will be in effect. Third, the resulting overstatement of ComEd's rate base will unavoidably result in the Commission exceeding its expressly limited authority under Section 9-211 of the Act to "include in a utility's rate base only the value of such investment . . . both prudently incurred and used and useful in providing service to public utility customers." 220 ILCS 5/9-211.

It is IIEC's position that the test year concept -- as codified in the Commission's test year rules (including the rule on pro forma adjustments) and interpreted by reviewing courts -- prevents a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *BPI II* at 238. IIEC says ComEd's adjustment for plant additions does precisely what the test year concept is meant to prevent, by pairing the year end 2006 test year accumulated depreciation balance with a test year rate base adjusted to include gross plant additions through third quarter 2008. This timing mismatch improperly inflates ComEd's net plant balance and its adjusted test year rate base according to IIEC.

IIEC reasons that the Commission's most thorough and thoughtful analysis of this issue, the decision in the AIU Cases, should control. IIEC argues that the Commission's analysis in that case requires that where net plant is static or declining, the Commission will closely scrutinize pro forma adjustments for proposed post-test year plant additions, since they are likely to inflate the rate base. Where net plant is increasing, the Commission might be inclined to allow post-test year plant additions, but only to the extent that they exceed increased accumulated depreciation. IIEC notes that in every circumstance, the Commission's inquiry addresses the change in "net plant," which is the quantity in the rate base on which rates are properly based. As IIEC witness Gorman explained, changes to net plant (not gross plant) are the driver of changes to rate base and cost of service. IIEC Ex. 6.0 Corr. at 16. IIEC's analysis and recommendation in this case followed the analysis of the AIU Cases, applied to the facts of record in this proceeding.

IIEC says a failure to recognize that the accumulated depreciation component of net plant (and rate base) changes while plant additions are made over a post-test year period of almost two years would inflate the resulting calculation of rate base beyond the express limitation of the statutory definition of a public utility's rate base. An inflated rate base would unavoidably result in an overstatement of the utility's calculated cost of capital, IIEC argues.

According to IIEC, ComEd's choice of a historical test year was evidently designed to implement a strategy of augmenting its test year rate base with unbalanced pro forma adjustments -- through a timing mismatch, adjusting gross plant 21 months beyond the test year, while leaving the accumulated depreciation reserve at the test year level.

IIEC says ComEd unreasonably extends past Commission decisions to provide a basis for its one-sided adjustment. Mr. Gorman testifies that those past decisions are readily distinguished, making the anomalous approaches of past decisions inapposite. IIEC's Mr. Gorman testifies that (unlike the proposals described in past cases) "I wasn't attempting to restate accumulated depreciation into 2008, but rather . . . attempting to properly and accurately estimate the net plant impact associated with post test year plant additions."

Moreover, according to IIEC witness Mr. Gorman, the Company's behavior contradicts its argument, since "the Company made some post test year adjustments to accumulated depreciations (sic) for events that increase rate base but refuse to make it for those that decrease rate base." *Id.* at 853. IIEC argues that ComEd's proposal to add its gross plant additions during almost two years following its chosen test year to rate base is so extraordinary that it alone distinguishes previous instances in a pattern of expanding abuses of the pro forma rule.

According to IIEC, accepting ComEd's proposal here would continue the expansion of unbalanced pro forma adjustments in recent ComEd cases charted in IIEC's brief, the mismatch of costs and cost offsets, and the divergence from test year principles and the Act's mandate for just and reasonable rates. IIEC observes that, in prior decisions that ComEd does not cite, the Commission has ordered recognition of

matching post-test year changes to more accurately reflect the costs and revenues expected for the period during which rates will be in place.

Finally, even though the prior decisions ComEd and Staff cite are viewed as factually distinguishable, IIEC asks -- if those decisions are deemed to constrain the Commission's determination on the evidence in this case -- that the Commission re-examine, and disavow, those past decisions, adopting the analysis of the AIU Cases. IIEC argues that the Commission cannot seek to blindly replicate past results, but is required to decide each case on the record evidence. IIEC says with the knowledge gained from experience under these decisions, the Commission should reconsider its prior rulings. Illinois utilities have demonstrated their ability and willingness to take advantage of anything less than an absolutely rigid construction of Section 287.40, to the detriment of ratepayers. Since, its prior decisions are not res judicata, *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d 509 (1953) at 513, the Commission has both the authority and a legal duty to change its position when the evidence requires it.

In response to parties' initial briefs, IIEC notes that ComEd and Staff focused on the provisions of their Stipulation instead of the substantive analysis of the ComEd proposal adopted in the stipulation. IIEC also responds to ComEd's attempt to limit application of the rule to items they choose and to subordinate the rule to that utility choice. There is a danger, IIEC contends, that the resulting distortion would make the adjusted test year data less representative than the unaltered test year data.

In response to ComEd's claims that a pro forma adjustment to recognize changes in accumulated depreciation "disregard that the rule prohibits adjustments based on '[a]ttrition or inflation' (the depreciation on test year plant in their proposal being attrition over time)" (ComEd Br. at 33), IIEC argues that the word "attrition" has not been used as a synonym for "calculated" in proceedings before this Commission. IIEC says attrition has been described as "primarily the result of the effect of inflation on operating expenses and rate base, the loss of margin from declining sales volumes, and increases in the cost of capital as a consequence of the rising cost of senior securities." Peoples Gas Light and Coke Company, Docket 82-0082, 1982 Ill. PUC LEXIS 1 at 29. IIEC also notes that because of utility group accounting, ComEd's actual depreciation expenses (and its own depreciation adjustments) are calculated in the manner ComEd criticizes.

In response to Staff's brief, IIEC argues that the ComEd-Staff Stipulation provision to correct errors in estimated plant addition costs contradicts their assertion that the costs are "known and measurable." Also, IIEC contends, ComEd and Staff have agreed to "carry forward" ComEd's test year plant in service to June 2008, changing the test year for gross plant in precisely the way ComEd says would make the proposed accumulated depreciation adjustment unacceptable.

(v) CUB

CUB argues the proposed adjustments to post-test year plant in service are selective and one-sided. CUB further argues they do not recognize other known and measurable plant in service related changes that will occur during the period from which

they have selected post-test year plant additions. CUB contends the changes the Company ignores would tend to offset the revenue requirement effects of the post-test year additions to plant in service. CUB asserts in particular, the Company recognizes only the increase in accumulated depreciation that is directly related to the forecasted plant additions. CUB claims that ComEd's proposed post-test year changes do not recognize the growth in accumulated depreciation on embedded plant in service that will be taking place as the new plant additions are going into service.

CUB recognizes that during the rebuttal phase of this proceeding, Staff and ComEd entered into a Stipulation in which they agreed to adjustments to plant in service, accumulated depreciation, ADIT, and depreciation expenses related to the OCA. In addition, Staff agreed that it will not advocate that any conclusions or recommendations identified in the OCA Report should be adopted or ordered by the Commission in the Audit Docket or that any adjustments in the Report should be made except as outlined in the Stipulation. AG/CUB Ex. 8.0 at 7. CUB points out that Staff and ComEd have further stipulated to limit the Company's pro forma adjustment to rate base for post-test year plant additions to those additions that actually go into service by June 30, 2008. *Id.* at 2. CUB argues that because the Stipulation specifies that no more than the actual plant additions through June 30, 2008 can be included in the final rate base determination, this adjustment would now be little more than a place holder. *Id.* at 5. Finally, CUB maintains the Stipulation no longer recognizes any growth in Staff's revised schedules for the balance of accumulated depreciation beyond the end of the test year.

CUB points to the Commission's rule on pro forma adjustments 83 Ill. Admin. Code §287.40 for the proposition that all changes in plant should be recognized along with post-test year plant additions. CUB argues the Commission should adopt the same treatment in this case that it ordered in other cases under similar circumstances and offset the Company's post-test year additions to plant with the post test year growth in the depreciation reserve, thus avoiding a mismatch of these major elements of rate base. CUB recognizes that in a recent Ameren rate case, the Commission clearly acknowledged that the AmerenUE net plant balance was increasing, but concluded that UE's proposed additions to plant in service should be included in rate base, but only "to the extent that they exceed increased accumulated depreciation." AmerenCIPS and Union Electric Co. (AmerenUE), Docket 02-0798, *et. al.*, (cons.), Order at 10-11, (Oct. 22, 2003). CUB asserts the Commission concluded that this treatment "more accurately matches the costs and revenues that may be expected for the period during which the rates are in place." *Id.* CUB argues there is no basis to distinguish the circumstances in this case from those of Docket 03-0009. Accordingly, CUB recommends that the Commission should order the same balanced treatment of pro forma changes and offset the Company's post-test year additions to plant with the post-test year growth in the depreciation reserve, avoiding a mismatch of major elements of rate base.

CUB recognizes that any reasonable interpretation of the Commission's findings in the other cases, Docket 02-0837 involving CILCO and Docket 03-0008 involving CIPS, also supports offsetting adjustments to include post-test year plant additions by the known and measurable growth in the balance of the accumulated reserve for

depreciation that will occur as plant is added. CUB claims that in those cases, there was no increase in net plant over the relevant time period. CUB states that the increase in plant in service was matched or exceeded by changes in accumulated depreciation.

CUB argues that the Commission must recognize that as the future plant additions occur and the balance of gross plant increases, the accumulated reserve for depreciation will also continue to grow as a result of recording depreciation expense on total plant in service. Thus, CUB avers that the net plant in service included in rate base will not increase by an amount equal to future additions. CUB claims that when growth in the balance of the accumulated reserve for depreciation is taken into account, the effect of growth in rate base due to plant additions will be mitigated significantly. According to CUB, it makes little sense to allow a selective pro forma adjustment to increase rate base for post-test year plant additions when the Company's actual growth in the net plant in service -- along with its rate base and associated revenue requirement -- will be substantially less.

(vi) Staff

As set forth in the Staff and ComEd Stipulation, Staff withdrew its adjustment to adjust plant and service and accumulated depreciation balances to the actual amounts known on December 31, 2007. Staff originally proposed the adjustment in Staff witness Griffin's direct testimony. The basis for Mr. Griffin's adjustment was that ComEd originally proposed pro forma additions for a twenty-one month period which included all of 2007 and the first three quarters of 2008. Mr. Griffin explains that because actual amounts for 2007 were known, the Company's pro forma adjustments should not produce a result that was inconsistent with the actual operating results for which the pro forma adjustments were intended to represent. For that reason he proposed adjusting plant and service and accumulated depreciation to the balances on December 31, 2007 actually in existence. Staff Ex. 2.0 Corr. at 7-8.

Staff witness Griffin's Rebuttal Testimony explains the basis for withdrawing the adjustment. Staff witness Griffin originally proposed the adjustment because in his opinion ComEd was proposing a comprehensive restatement of its plant balance from the end of the test year 2006 forward 21 months to September 31, 2008. Mr. Griffin proposed his adjustment to mitigate the shift in the test year from December 31, 2006 to September 31, 2008. Staff Ex. 15.0 Corr. at 8-9. Mr. Griffin further testifies that he withdrew his adjustment given that as part of the Stipulation ComEd agreed to limit its pro forma adjustments to plant additions through June 30, 2008. Because there was no longer a comprehensive restatement of plant balances, Mr. Griffin found the adjustment to no longer be necessary.

Staff adds that Mr. Griffin testified that the pro forma adjustments though June 30, 2008 agreed to by ComEd in the Stipulation are reasonable and meet the known and measureable standard of 83 Ill. Adm. Code §287.40.

In its Exceptions, Staff submits that it is improper to rely upon the Commission's prior Order in Dockets 02-0798, *et. al.*, to support the conclusion proffered by the AG's, CUB's and IIEC's adjustment regarding accumulated provisions for depreciation and amortization. Staff BOE at 22-23. Staff asserts that the relevant facts in this case are

inapposite to the facts in Dockets 02-0798, *et. al.*, which was a case in which the utility's historical net plant in service was declining or relatively static. In the case at bar there is significant evidence that demonstrates the Company was continuously investing in its system resulting in increased plant. Staff submits that due to this clearly differing fact situation the analysis from the Ameren case is inapplicable to the instant proceeding. Of significant importance, Staff points out, is that the ALJPO ignores recent Commission dispositive Orders on the issue, in particular the Orders in Docket 05-0597, ComEd's 2005 rate case; Docket 01-0423, ComEd's 2001 rate case; and most recently Docket 07-0241/07-0242 (consolidated), North Shore Gas and Peoples Gas 2007 rate case.

(vii) Commission Analysis and Conclusion

The Commission must evaluate the record to determine whether the proposed pro forma capital additions satisfy the requirements of 83 Ill. Adm. Code Section 287.20, 287.40 and the Act. They must also be consistent with the principles underlying the test year rules. Staff and the Company propose to include pro forma capital additions through June 2008 with no reflection of the increase in the accumulated reserve for depreciation on embedded plant. Alternatively, if this proposal is not adopted, the Company posits that its original position to include pro forma plant additions through September 2008, with no reflection of the increase in the accumulated reserve for depreciation on embedded plant, be adopted. These are plant additions that ComEd maintains are reasonably certain to occur within 12 months from the date of filing, October 2007.

As mentioned earlier in this Order, historically the Commission has welcomed consensus recommendations arrived at by groups of litigants, and they are presented routinely, notably in Dockets 99-0017, 01-0423, 01-0707, 02-0727, 03-0705, 04-0683, 01-0706,02-0726,03-0704 and 04-0682. In this instance, of key importance is that neither Commission Staff nor the Company are requesting that the Commission enter an Order approving the agreement or Stipulation that they have reached regarding resolution of various issues in this matter. Instead, the Commission, as we are lawfully mandated to do, will conduct a *BPI* analysis and base our determinations and ultimate conclusions on the applicable law and merits of the record evidence. The Commission observes that 83 Ill. Adm. Code Section 287.40 provides in pertinent part:

A utility may propose pro forma adjustments (estimated or calculated adjustments made in the same context and format in which the affected information was provided) to the selected historical test year for all known and measurable changes in the operating results of the test year. These adjustments shall reflect changes affecting the ratepayers in **plant investment**, operating revenues, expenses, and cost of capital where such changes occurred during the selected historical test year **or are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable.** (Emphasis added). In this case the Company has proposed certain pro forma changes in plant investment that it submits satisfy the requirements of this above referenced provision. Additionally, ComEd posits that the subject changes are

determinable and reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs, *i.e.*, through the end of the third quarter of 2008. Staff, in its rebuttal testimony, stated that after a close analysis of ComEd's additional evidentiary documentation regarding the pro-forma costs at issue it supports inclusion of those costs in rate base.

Based on our review of the factual record herein the Commission finds that the evidence, coupled with the relevant legal standards, supports the conclusion that the pro forma additions for the first and second quarters of 2008 meet the requirements of Section 287.40 and are therefore properly included in rate base. Staff originally proposed disallowing all capital additions beyond December 2007 and recommended that the accumulated reserve for depreciation at that time be reflected, but Staff witness Griffin states that he would consider any additional evidence the Company provided in its rebuttal testimony. In particular, in his Rebuttal Testimony Staff witness Griffin testifies that his review of the extensive additional support provided by the Company shows that (1) capacity expansion projects which composed some of the pro forma additions were summer critical and were required to be closed by June 1, 2008; (2) some of the projects were required to be closed by specific times by a government entity; (3) the capacity expansion projects are considered short term CWIP that do not accrue AFUDC and (4) the projects have contracts with completion dates and costs.

Noteworthy is the testimony of ComEd witness Donnelly that $114.1 million of distribution projects had already been placed into service as of February 29, 2008 and many of the remaining projects are summer critical, *i.e.*, projects to be constructed and in service by June 1 prior to the hottest part of the summer when ComEd's system usually hits its peak. ComEd Ex. 21.0 Corr., 24:513-516. Thus, many of these pro forma plant additions are reasonably certain to occur and in many instances have occurred and are currently ensuring enhanced reliable electrical service to ComEd customers. ICC Staff Ex. 15.0 Corr. at 6. For these reasons, the Commission finds compelling Staff's revised position that ComEd's proposed pro forma adjustments which included the projected 1st and 2nd quarter 2008 additions are known and measureable under the Commission's test year rules for historical test years and clearly satisfy the requirements of 287.40 and should be included for test year rate base purposes.

The AG, CG, CUB, and IIEC offer the proposition that net plant, not gross plant, is the determining factor in calculating total utility rate base and that all offsetting adjustments from the revenue requirement test year and from post-test year period should be included in the calculating rates to comply with the "matching" and "representative" requirements of the test-year principle. These parties submit that the Commission should find controlling its Orders in Illinois Power Company, Docket 01-0432, Order at 20-21 (March 28, 2002), as well as Union Electric Company, Proposed general increase in natural gas rates, Docket 03-0009, Order at 9-10 (October 22, 2003). We note that these arguments are not novel arguments as the Commission has reviewed the merits of this position in at least three cases in the recent past. Most recently in our Order in the Peoples Gas rate case *supra*. The AG/CUB initially failed to mention or distinguish this case from Docket 05-0597 and the Peoples rate case entered just six months ago. IIEC, for its part, recognizes the import of the

Commission's three prior decisions on this issue and suggests that the Commission disavow those Orders as inconsistent. We do not agree.

The Commission is not persuaded by the reconstituted arguments that the AG/CUB/IIEC propose with regard to this issue. These parties argue that the Commission should treat this pro forma adjustment consistent with our Order in Dockets. 02-0298, 03-0008 and 03-0009 (Consolidated) (Ameren CIPS and Ameren UE 2002 gas rate cases). We pointed out in those Orders "where historical plant in service is either declining or static, post test year pro forma increases in plant in service require further analysis lest, by viewing those adjustments in isolation, it appears that there should be an increase to rate base when, in fact, after netting out the effect of declining plant in service and Depreciation Reserve with the pro forma additions, there should be a decrease in rate base." Docket 03-0009, Order at 9 (October 22, 2003). However, in this case, as was the case in ComEd's 2005 rate case ComEd's net plant in service is increasing. Therefore, this case, like Docket 05-0597, is distinguishable from Dockets 02-0298, 03-0008 and 03-0009 (Cons.). Regarding Illinois Power Company, Docket 01-0432, we observe the decision to advance the depreciation balances on test year plant reflected an agreement between Illinois Power and Staff, with little discussion of the facts and circumstances relevant to that case. We find that these cases do no lend sufficient support for the Commission to disavow its repeated determinations on this important issue.

Moreover, a major concern regarding the adjustment to test year depreciation, pointed out in the Order in Docket 05-0597, has not been resolved in this case. Namely, that the proposed adjustments do not correlate with any pro forma adjustments. "Instead, the … proposal merely takes one part of the rate base and moves it one additional year into the future." Docket 05-0597, Order at 15 (July 26, 2006). The Commission observes that the pro forma adjustments proposed in this matter by the Company and supported by Staff reflect 18 months of investment beyond the test year. We note that the Order in the North Shore Gas and Peoples Gas 2007 rate case allowed pro forma additions through February 2008, 17 months after the end of the test year, September 30, 2006. Dockets 07-0241/02-0242 (cons.), Order at 7, 16-17 (February 5, 2008). Additionally, in that case the Commission was confronted by the same arguments asserted by the same parties. In that Order, the Commission strove to make clear how it would apply this standard. In that Order we stated:

> "All parties agree that this issue has been previously addressed by the Commission. All parties largely agree that the facts differ from one case to another. All parties should agree that Commission action brings certainty to a situation and settles expectations. This is another way of saying that unless there are clear and distinguishable reasons for deciding a case differently, the Commission will follow in line with precedent. To do otherwise risks a charge of arbitrary and capricious action." *Id.*

In the instant docket, we are asked to look at the same arguments that we considered in Peoples, Dockets 05-0597 and 01-0423 against the backdrop of consistent fact patterns. Nevertheless, the Commission has, as it is required to do, performed its analysis based on the record before us in this matter. The Commission is

mindful that in each previous case where a utility was investing in its system at a rate such that net plant was increasing at a significant rate year after year, the Commission has rejected the notion that the AmerenUE/CIPs Order is applicable or a legal viable argument. Based on the record herein, we find no differing fact pattern that would cause us to disavow our previous determinations on this issue. To rule otherwise would require us to ignore the facts, legal standards and adopt and arbitrary standard of review. To reiterate our Order in Peoples stated as follows:

> "… In our view, and under our analysis, the outcome of the 05-0597 proceeding is controlling on the dispute at hand. Indeed, we are shown nothing as would have us depart from the decision that the Commission set out in that matter. … Thus, we are unable to lawfully deviate from that conclusion." Docket 07-0241/07-0242 (Cons.), Final Order at 16-17.

The Commission is cognizant that each record is separate and distinct and must be afforded individual scrutiny. In order for the Commission to do an about face with regard to its prior decisions, parties must make a clear showing as to the appropriateness of such a change by way of proper evidentiary and legal support for us to consider such departures from settled precedent. Indeed, the record in the instant case provides no such support for disavowing our past determinations on this issue. For the foregoing reasons, the Commission rejects the adjustments to test year depreciation proposed by the AG/CUB and IIEC as legally insufficient and not supported by the record.

(b) Accumulated Deferred Income Taxes ("ADIT")

(i) ComEd

ComEd asserts that its calculation of its ADIT balance should be approved. ComEd explains that it started with the jurisdictional figure for ADIT as of the end of the test year, December 31, 2006, and then made the correct adjustments needed to reflect the impacts of its proposed adjustments to plant, including its pro forma adjustments for post-test year capital additions, using the same methodology that it employed, and that the Commission approved, in ComEd's 2005 and 2001 rate cases. ComEd Ex. 7.0 Corr. at 19, 34-36; ComEd Ex. 7.1, Sched. B 1 at 1, l. 11, column (C), Sched. B 2 at 1, l. 11, column (B), Sched. B 2.1.

Using the same theories they invoked for their improper proposed adjustments to the Depreciation Reserve for post test year depreciation expense on test year plant, AG/CUB and IIEC propose to add more ADIT related to test year plant, in the amount of $88,297,000 and $87,673,000, respectively. Their proposals to inflate ADIT for test year plant should be rejected for the same reasons that their proposed adjustments to the Depreciation Reserve should be rejected. The proposed adjustments are unwarranted and inconsistent with the test year and pro forma adjustments rules and past Commission Orders. ComEd Ex. 25.0 Corr. at 26; ComEd Ex. 40.0 Corr. at 17-20.

Moreover, the proposal is incorrect for the additional reason that, while AG/CUB and IIEC argued that net plant changes should be the basis of the calculation of pro forma capital additions, the definition of net plant does not include ADIT. E.g., Griffin, Tr. 668 669, 677, 681. So, even under the AG/CUB and IIEC arguments about the Commission's rules, their proposed adjustment still lacks merit.

(ii) AG

The AG argues that, as with accumulated depreciation, it is improper and inconsistent to include post-test year plant additions in rate base without recognizing that a portion of those additions will be financed by the customer supplied, zero-cost capital represented by the growth in accumulated deferred income taxes. Therefore, the AG argues that the test year balance of ADIT should be adjusted to reflect the growth that will be available to finance the growth in plant balances after the test year. ComEd has not recognized the source of funds that will be provided by the growth in ADIT as the post-test year plant additions go into service and it will continue to record tax depreciation in excess of book depreciation on plant in service. That excess depreciation will reduce income taxes currently payable, thereby providing cash that is available to finance its post-test year additions to plant.

AG/CUB witness Effron has calculated the growth in the balances of plant-related ADIT based upon the actual balances through September 30, 2007, the most recent data available from the company. These calculations show growth of $100,845,000 in the balance of plant related ADIT from December 31, 2006 to September 30, 2008, which is $88,297,000 greater than ComEd's adjustment to the balance of ADIT. AG/CUB Ex. 5.1, Sched. B-2. Therefore, the AG recommends that the pro forma balance of ADIT deducted from plant in service in the computation of rate base be increased by that same amount. Reducing ComEd's adjustment for post-test year plant additions by related growth in the balance of ADIT does nothing more than allow investors to earn a return on their actual investment in utility operations – but only on that actual investment. Unless the Commission intends to authorize ComEd to earn a return not on post-test year plant additions that are financed by customers, the AG says that the post-test year growth in the balance of ADIT that is used to finance the post-test year plant additions must be recognized.

(iii) CG

CG supports the arguments of the AG.

(iv) IIEC

For the same reasons the Commission must take account of the change in accumulated depreciation in connection with ComEd's pro forma adjustment for plant additions, IIEC recommends that the Commission recognize a pro forma adjustment for ADIT over the same period ComEd proposes to recognize plant additions, for an accurate determination of rate base.

(v) Commission Analysis and Conclusion

Consistent with the Commission's analysis concerning accumulated provisions for depreciation and amortization, the Commission rejects the AG, CG, and IIEC proposed adjustments to ADIT.

The AG's Brief on Exceptions noted that the Proposed Order adopted the Company's calculation for the impact of the Economic Stimulus Act, which was based on plant additions for the first two quarters of 2008. Based on the decision above granting two quarters of plant additions in 2008, the adjustment for ADIT related to the Economic Stimulus Act must be modified to reflect the plant additions through the second quarter.

b) Underground Cable and Services

(1) ComEd

ComEd's proposed rate base includes the cost of underground distribution cable and service lines. According to ComEd, it has presented sufficient evidence to prove the prudence of the investments and the reasonableness of the costs incurred. For example, ComEd has presented evidence that the underground cable and service are useful to customers; that the cost of construction is reasonable given the escalating cost of labor and materials; and that ComEd has procedural controls in place to ensure the efficiency and necessity of new construction projects. ComEd Ex. 4.0 2nd Corr. at 30, 36, 41-42.

ComEd asserts that it has proven that the underground cable and services are used and useful, and were acquired prudently, at reasonable cost. A utility that establishes these facts, ComEd argues, is legally, indeed constitutionally, entitled to recover those costs. Staff witness Lazare, who proposed to disallow $111 million (gross plant amount) from plant in service ($104.6 million from rate base) relating to underground lines and services, could not point to a single cable or service asset that is unused or not useful, was purchased or installed imprudently, or could have been acquired at the time for a lower cost. Lazare, Tr. at 1746-47. In any event, it has never been the law that a utility, to support its rate request, must identify, explain and justify every individual component of an investment or group of investments (distinct from the construction projects of which they were a part). Neither Commission rule nor long-standing practice requires a utility to explain why the prudent and reasonable costs of equipment that it purchases and installs have increased; it only needs to prove that it acted prudently and that the costs were reasonable. ComEd simply does not maintain the type or level of detail Staff now seeks here. ComEd Ex. 37.0 at 2-3. If the Commission does decide that utilities should maintain and produce this level of detail, its rules should be amended prospectively to provide so.

ComEd maintains that its obligation is to follow the Commission's rules regarding new plant in rate base and present evidence that those additions are used and useful in serving customers, and that they were prudently acquired at reasonable cost. 220 ILCS

5/16 108(c); *Citizens Util. Bd. v. Illinois Comm. Comm'n*, 166 Ill. 2d 111, 121 (1995) ("CUB"). The Commission's rules set forth the obligations imposed upon a utility in its initial filing and in its initial testimony with respect to additions to rate base. 83 Ill. Adm. Code Section 285.6100 prescribes what the utility must provide in the Part 285 filing as to major additions to rate base, the so-called "Schedule F-4" projects, and 83 Ill. Adm. Code Section 286.20(a)(2) specifies what the utility must include in its direct case about the Schedule F-4 projects. In its initial filing, ComEd met each of the Commission's requirements relating to additions to rate base since its last rate case. The testimony of Mr. McMahan described all the Schedule F-4 projects as well as relevant supporting documents.

Beyond that, ComEd believes it has introduced a raft of evidence showing the prudence, reasonableness and cost justification for all of its additions to rate base, including underground cable and services. ComEd Ex. 4.0 2nd Corr. at 42, 55-56. ComEd describes at some length the various factors that were causing its investment costs to increase: the steep increases in equipment such as cable, poles and transformers; and the extraordinary price increases in commodities such as copper that resulted from strong worldwide demand for such commodities. ComEd Ex. 4.0 2nd Corr. 13–14. ComEd further explains that it manages every capital project either as a unique project (all projects over $100,000) or as a blanket project (individual projects under $100,000). In 2005 and 2006 ComEd installed $770 million of plant additions as blanket projects. ComEd explains the nature of the blanket programs and described how the costs of such blanket projects are managed, controlled, accounted for and reported. ComEd Ex. 5.0 Corr. at 30-31.

ComEd also retained the energy consulting firm, Power Delivery Research & Consulting Corp. ("PDR&C") to perform a top-down review of ComEd's major capital projects and its largest blanket programs. In the course of that work, PDR&C interviewed ComEd personnel, gathered relevant project-related documentation, and drafted evaluations of the projects analyzed. ComEd relies upon the PDR&C reports and supporting documentation to support its conclusion that its investment in each of the projects was prudent, that the costs incurred were reasonable, and that the investment is used and useful in providing utility service. ComEd Ex. 5.0 Corr. at 15-16. In 2005 and 2006, ComEd spent $285.8 million on the installation of 25 million feet of cable and wire for 106,700 new services for residential and commercial customers. PDR&C also studied the eight blanket programs through which ComEd, in 2005 and 2006, installed those new services. Two PDR&C reports in this area are of particular significance: "Install New Services for Residential Customers" and "Install New Services for Commercial Customers (both June 25, 2007). PDR&C prepared a separate report that explained the $126 million in capital costs ComEd incurred through five blanket programs involving underground cable replacement and installation: "Emergency Replacement of Electrical Underground Equipment" (June 25, 2007).

ComEd points out that none of the sources of information it made available were reviewed by Mr. Lazare. ComEd adds that Mr. Lazare admitted that he had no evidence that any of the costs of the cable and services were imprudent or unreasonable. Tr. at 1746-47. ComEd notes that it maintained data rooms in both

Springfield and Chicago containing documents relevant to plant additions; that it engaged a third-party consulting firm to independently evaluate ComEd's construction projects; and that it made ComEd operations personnel available for interviews. Though ComEd believed that at least three of the independent evaluation reports would have been directly relevant to Mr. Lazare's inquiry and the numbers used in his calculations, he neither looked at them nor asked any questions about ComEd's construction programs. Tr. at 1728, 1739.

ComEd asserts that it has shown that the mathematical analysis advanced by Mr. Lazare was flawed in five critical ways. First, ComEd explains that the "unit cost" calculated by Mr. Lazare was a meaningless and arbitrary number, because it used the total amounts in entire Uniform System of Accounts ("USOA") accounts. ComEd also notes that changes in this number are heavily influenced by changes in other components of the accounts. In addition, ComEd notes that a quick look at the Staff exhibit that summarizes these increases (Staff Ex. 5.0, Schedule 5.1) shows that average per unit costs fluctuate heavily on a year-over-year basis, ranging between $96,448 (2000) and $270,657 (2006) per mile for underground cable. Such grossly fluctuating "per unit" costs suggest that many extraneous factors must be clouding the analysis, but Mr. Lazare ignored all external factors entirely.

Second, ComEd points out that Mr. Lazare divided the costs by the number of miles of primary conductor, which does not include hundreds of miles of secondary cable also included in the costs. Third, ComEd shows that an arbitrary choice of the five-year period from 2000-2004 for comparison resulted in a 19.5% higher "average unit cost" than if the four-year period from 2001-2004 had been used. Simply eliminating one year (2000) from the analysis reduced the recommended disallowance by 75%. Fourth, Mr. Lazare assumes, rather than proves, that his calculated increase in costs constitutes unreasonable increases, without reference to industry benchmarks or any other real world context. Fifth, ComEd criticizes Mr. Lazare's hypothetical proxy for an allowable rate of cost increase.

More significantly, alternative ways of looking at Mr. Lazare's own data show that the 2005 and 2006 "per unit" costs, even taken at the face value Mr. Lazare would assign to them, are not out of line with prior costs. For example, in 2002, the "per unit" cost was $217,990; if that were escalated at 4% per year, corresponding numbers for 2005 and 2006 would be $245,209 and $255,017 respectively (or a per-mile weighted average of $245,401). Actual ComEd numbers as reflected on Mr. Lazare's schedule 5.1 were actually less than that: $225,498 and $270,657, respectively (or a weighted average of $245,170). Looked at this way, Staff's own numbers show no increase at all, much less an unexplained one.

ComEd believes that it is only fair that it be judged against a standard established before it books its investments, not after. Any requirement that ComEd retain data about, and then separately quantify and justify, the share of each FERC account that consists of the cost of capitalized labor, as opposed to other costs, such as materials, would amount to a new data requirement in this case, imposed retroactively. To hold that it could not recover its costs unless it could provide a break down of capitalized labor by FERC account in this manner would be fundamentally unfair.

ComEd also claims that it would be illegal. *Illinois Power Co. v. Illinois Comm. Comm'n*, 339 Ill. App. 3d 425, 439-40 (5th Dist. 2003) (reversing Commission decision that "created after the fact the standard of care … and applied it in hindsight to judge the prudence" of the utility's decision (emphasis in original)).

ComEd has never been required – by the USOA, GAAP, the Act, the Commission's rules, or any previous Commission order – to maintain capitalized labor costs by project. Tr. at 1741-1743. Staff itself has never, even informally, requested that ComEd track this data. Mr. Lazare admits that ComEd is in compliance with the USOA, that tracking capitalized labor is not required by any law or order, and that he was unaware of there ever having been a request – of ComEd or any other Illinois utility – by Staff's accountants to maintain capitalized labor statistics. *Id.*

ComEd explains that in any event, the information Mr. Lazare sought is, at best, a starting point for a meaningful evaluation of ComEd's management decisions. If, of the $482 million ComEd invested in plant additions for underground lines in 2005 and 2006, ComEd had reported that $200 million constitutes capitalized labor, it is inconceivable how that information alone would be probative on the question of overall reasonableness of costs. Mr. Lazare also complains that ComEd was unable to produce a breakdown of the costs of a variety of listed materials that must be reported in the USOA accounts. For instance, costs included in USOA Account 366 are costs related to, inter alia: "ventilation equipment, sump pumps… permits … municipal inspections…" 18 C.F.R. 101, adopted at 283 Ill. Admin. Code §415.10. Mr. Lazare did not explain how this data, if produced, would aid the Commission in reviewing ComEd's rate base. ComEd's inability to produce such breakdowns does not call for a disallowance.

In its Initial Brief, Staff presents a new calculation that Mr. Lazare did not present in, and is contradicted by, his testimony. Staff Init. Br. at 14-15. Staff takes one of Mr. Lazare's incorrectly calculated numbers, a supposed $207,159 per mile for underground cable, and compared it to a number from of a graph on page 36 of Mr. Williams' direct testimony, and then claims that only 1.2% of ComEd's costs of cable installations were attributed to the costs of materials. (Mr. Lazare himself estimated this figure at 27.6%. *See* Staff Ex. 5.2 at 2.) No testimony supports this calculation, and it is not valid. It is inappropriate to take the wrong total cost per mile figure, and compare it to an isolated cost of one type of material.

ComEd states that Staff's arbitrary, after-the-fact analysis does not adhere to the recognized legal framework for judging rate base additions and was factually erroneous. ComEd adds that such a theory was insufficient to erase over $100 million of real assets from ComEd's rate base. For these reasons, ComEd urges the Commission to reject Mr. Lazare's proposed disallowance.

(2) Staff

Staff proposes adjustments for 2005 and 2006 plant additions associated with underground lines and services. Staff asserts the adjustments are necessary because ComEd thoroughly failed to provide reasonable evidence justifying the levels of its proposed additions. Staff further asserts that proposed adjustments are reasonable

because they are based upon the most rational assumptions concerning the trajectory of costs for underground lines and services given the available evidence in this proceeding. Specifically, Staff proposes adjustments of $74.69 million for underground lines and $36.26 million for services, or a combined $110.95 million for these two sets of costs. Staff Ex. 5.0 at 24.

ComEd proposes in this case to include in rate base a total of $482 million in plant additions for underground lines over the years 2005 and 2006. It also seeks recovery for $127 million in plant additions for services over those same years. Staff Ex. 5.0, Schedule 5.1.

ComEd witness Williams presents the principal support for the proposed additions. He argues that the costs of plant equipment have escalated in recent years. ComEd Ex. 4.0 at 36:711-712. In support, Mr. Williams provides cost data for certain materials associated with distribution assets for the years 2002-2006. According to Mr. Williams' data, costs for substation transformers and overhead conductor costs both increased by 110% between the years 2002-2006. He also finds that costs for underground cable and poles have increased by 60% and 30%, respectively, over this time period. So, for example, Mr. Williams identifies an increase in ComEd's material cost for underground cable from $1,650 to $2,600 per mile from 2002 to 2006. ComEd Ex. 4.0 at 14:262; 36-37:717-719. This amounts to an increase of $950, or approximately 60%, per mile over this period. Staff Ex. 5.0 at 16.

It is Staff's position that the evidence provided by ComEd witness Williams does not constitute meaningful support for the Company's proposed rate base additions. The material costs he cites represent only a small fraction of the requested 2005 and 2006 plant additions for underground lines and services. For example, the average total cost for underground line plants additions per mile is $207,159 Staff Ex. 5.0, Schedule 5.2 at 2, so Mr. Williams' testimony asserting an increase in ComEd's material cost for underground cable from $1,650 to $2,600 per mile explains only a fraction (*i.e.* 1.2 percent) of the total cost per mile ($2,600/$207,159 equals approximately 1.2%).

According to Staff, the problem with the Company's analysis is that Mr. Williams fails to support the balance of these costs, that is, the other 98.8% of the total per unit cost. For example, the Company identifies a variety of other materials costs for underground lines, including manholes, concrete, ventilation equipment, sump pumps, temporary installations for the permanent installation of conduit, permits, municipal inspections, insulated, submarine and lead cables (*i.e.* – secondaries), circuit breakers, insulators, tie wires and clamps associated with the racking of cables, lightning arresters, railroad or highway crossing guards, splices, switches, tree trimming, permits and other line devices. ComEd Ex. 22.0 Corr. at 4. However, ComEd provides no data on the costs of these other materials. Tr. at 737-738. Thus, the role of these additional items in shaping plant additions for underground lines cannot be determined.

According to Staff, not only does Mr. Williams' analysis lack data on the cost of individual materials, but he fails to provide materials costs as a whole for underground lines and services. Mr. Williams does not know, for example, the amount of materials cost associated with the proposed 2005 plant additions for Account 366, Underground Conduit and Account 367, Underground Conductors and Devices. Tr. at 734. Mr.

Williams also has not provided for the record a breakdown of services costs between material and labor. Tr. at 740.

Also, according to Staff, ComEd does not provide evidence supporting increases in the share of plant additions represented by non-materials costs. The Company indicates that non-materials costs consist of two components. One component is "Other Direct Costs" which includes items such as labor, contracting, engineering, departmental overheads, and other costs directly associated with projects, and the other component is "Other costs" which includes allowance for funds used during construction ("AFUDC"), administrative and general overhead costs, pension and benefits, taxes and other indirect costs. None of these costs is provided for the record. Staff Ex. 5.0 at 19-20. When asked specifically about the component of plant additions represented by capitalized labor costs, Mr. Williams acknowledges for the Company that they "don't break out specifically the labor costs itself." Tr. at 738.

It is Staff's position that the lack of information on these non-materials costs makes it difficult if not impossible for the Commission to understand their contribution to the overall increase in plant additions for underground lines and services from 2000-2004 to 2005-2006. The Company fails to explain whether these costs have increased and, if so, to what extent. This lack of evidentiary support prevents an examination of how these non-materials costs contribute to the overall increase in plant additions over this time period. Thus, according to Staff the Company fails to fully substantiate the increases in these accounts. Staff Ex. 5.0 at 20.

Staff contends that this lack of support also undermines Mr. William's conclusion concerning the Company's rate base that, "[w]ith respect to each of the assets that are already in service, the cost at which ComEd acquired and installed the asset was reasonable and prudent." ComEd Ex. 4.0 at 39. Staff also asserts that the lack of record evidence concerning the two essential components of materials and labor costs makes this conclusory statement unsupported as well.

Staff's conclusion concerning per-unit costs is based on comparing the miles of underground primary conductors installed over the years 2000 – 2006 with the amount of ComEd's plant additions associated with underground conduit, conductors and devices for each of those years. This comparison shows that the per-mile cost for the installation of underground lines has risen significantly over this period from an average per-mile cost of $164,642 for the years 2000-2004 to $245,170 for 2005-2006. This amounts to an increase of $80,528, or 48.9% over the averages for these two time periods. Staff Ex. 5.0 at 15-16.

Staff similarly derives per-unit costs for services by comparing the number of services installed each year from 2000 – 2006 with the amount of ComEd's plant additions for services over that same period. That analysis shows that the per-unit cost of those plant additions has risen significantly, from an average of $552 for the years 2000-2004 to $1,014 for 2005-2006. This amounts to an increase of $462, or 83.8%, for the unit cost between these two time periods. Staff Exhibit 5.0 at 17.

Staff asserts that ComEd's failure to meet its burden of proof and establish the reasonableness of these substantial increases would be reason enough to deny

recovery of these costs, Staff also engages in further analysis to gauge the reasonableness of these costs. Given ComEd's substantial increases in unit costs that Staff finds unsupported, Staff determines, based upon its analysis of the best available evidence, that ComEd's proposed plant additions pertaining to underground lines and services for the years 2005 and 2006 should be adjusted downward. The first step in developing this adjustment was to determine an appropriate level of 2005 and 2006 plant additions based on reasonable assumptions concerning the trajectory of materials and non-materials costs. Then, the difference between this level of plant additions and ComEd's proposed levels provided the basis for Staff's adjustment.

Staff employs a multi-step process to adjust the Company's proposed rate base for both underground lines and services. Staff seeks to determine a reasonable increase in unit costs from a base period, 2000-2004, to the years for which ComEd proposed additions, 2005-2006. Staff Ex. 5.0 at 21.

The first step of the process is to divide per-unit plant additions for 2000-2004 into two categories, materials and non-materials costs. The only evidence provided on this cost breakdown reveals that materials costs account for $310,770,132, or 27.6%, of $1,124,596,303 in total distribution plant additions for 2005 and 2006 combined. This means that non-materials costs account for the remaining 72.4% of distribution plant additions. Therefore, Staff assumes that 27.6% of the unit costs for both underground lines and services were materials costs and 72.4% were for other costs. Staff Ex. 5.0 at 22.

Staff's next step entails applying realistic increases supported by the record in this case to both materials and non-materials costs from the midpoint of 2000-2004 to the midpoint of 2005-2006 to develop unit costs for underground lines and services in this latter period. The per-unit materials and non-materials costs derived in this manner are compared to the average per-unit plant additions for 2005-2006 proposed by ComEd. Then, the difference on a per-unit basis was multiplied by the number of units to determine an overall adjustment for each item. Staff Ex. 5.0 at 22.

Staff's adjustment gives ComEd the benefit of the doubt and assumes that all materials associated with underground lines have increased by the same percentage as the 60% increase in underground line costs cited by Mr. Williams. ComEd Ex. 4.0 at 36. For services, Staff finds a 79.8% increase in materials costs for services to be appropriate. This 79.8% figure was derived as follows. Service lines can be installed both above and below ground. Thus, services costs are influenced by cost increases related to both overhead and underground lines. Company witness Williams indicates that the cost of overhead lines has grown by 110% from 2002-2006 and that the cost of underground lines has grown by 60% over this period. *Id.* at 36-37. Staff weighted the two growth figures by the number of miles of overhead and underground lines added by the Company since 2004, as presented in Mr. Williams' testimony. According to Mr. Williams, the Company added 3,246 miles of overhead conductors and 4,967 miles of underground cables since 2004. *Id.* at 45. ComEd Exhibit 4.0 at 45. Assuming overhead lines increased by 110% and underground lines by 60% produces a weighted average

increase of 79.8%. *See* Staff Ex. 5.0, Schedule 5.2 at 2. This figure provides a reasonable proxy for the increase in materials costs related to services. Staff Ex. 5.0 at 23-24.

For non-materials costs, Staff applies an average increase of 3.5% per year. This figure reflects the average 3.5% wage increase that ComEd employees have received over the years 2004-2006. ComEd Ex. 7.1, Schedule C-2.1. It should be noted, however, that this figure could overstate the increase in non-materials costs because it does not factor in productivity growth which would reduce the labor time necessary for installing underground lines and services. *Id.* at 24.

These assumptions are used to calculate adjustments for underground lines and services in Schedule 5.02 of Staff Ex. 5.0. The adjustments reduce 2005 and 2006 rate base additions for underground lines and services by $74.69 million and $36.26 million, respectively, or $110.95 million collectively. The proposed adjustment also includes related adjustments to proposed levels of accumulated depreciation, depreciation expense and deferred income taxes. Staff Ex. 5.0 at 24.

It is Staff's position that its proposed adjustments are reasonable given ComEd's failure to provide sufficient evidence, as explained above, to justify the increases in costs related to the 2005 and 2006 levels of plant additions for underground lines and services.

Staff also states that despite Mr. Williams' claim to the contrary, Staff does, in fact, question whether the amounts in ComEd's proposed plant additions "were actually spent". A key deficiency in ComEd's numbers is that it cannot provide the amount of capitalized labor hours for either 2005 or 2006 plant additions. ComEd states it "does not maintain records of capitalized labor hours to categories called services, meters, substations, substations transformers, primary distribution transformers and overhead and underground conductors." *See* Staff Ex. 18.0 at 2.

Staff explains that this omission means there is no way to independently assess whether the labor costs incorporated into the Company's plant additions were actually incurred; therefore, the overall accuracy of the proposed 2005 and 2006 plant additions cannot be independently verified. Staff Ex. 18.0 at 3. If ComEd cannot verify its own numbers, then Staff posits it cannot argue that a downward adjustment to that unsupported number is unreasonable. Nevertheless, this is what the Company argues.

Staff also contests Mr. Williams' claim that the per-mile cost of underground lines underlying Staff's adjustment is "erroneously" labeled as an "average" because it does not specifically account for the costs of other underground line components, such as "conduit, manholes, concrete, ventilation equipment, sump pumps, temporary installations for the permanent installation of conduit, permits, municipal inspections, and other things" for FERC Account 366 and "insulated, submarine, and lead cables (that is, secondary lines) circuit breakers, insulators, tie wires and clamps associated with the racking of cables, lightning arrestors, railroad or highway crossing guards, splices, switches, tree trimming, permits, and other lines devices" for FERC account 367. Staff responds that the reason it has not considered these costs is because they have not been provided by ComEd. As previously noted, ComEd provides no data on

the costs of these other materials. Tr. at 737:2-738:6. Staff developed its adjustment based on the Company's best available evidence. If Mr. Williams has concerns with that evidence, then Staff argues he should have taken steps to make the record more complete. Staff also responds that it is unfair and unreasonable – as well as irrelevant -- to criticize Staff's adjustment based on the paucity of the evidence ComEd has put on the record.

Staff similarly rejects Mr. Williams' contention that the analysis underlying Staff's adjustment is flawed because it does not explicitly consider cost components such as "brackets, cable and wire, conduit, insulators, municipal inspection, pavement cutting and replacement, permits, protection of street openings, service switching, etc." ComEd Ex. 22.0 2nd Corr. at 6.

In Staff's view, Mr. Williams criticizes Staff for not providing information that the Company itself failed to present in support of its proposed plant additions for services. Staff sought to develop the most reasonable adjustment given the level of information provided. ComEd, for its part, provides a paucity of information concerning services costs. The lack of information raises questions about the reasonableness of ComEd's proposed additions rather than Staff's adjustment to those additions.

Staff asserts that Mr. Williams' assertions that Staff's calculation of the unit costs per-service is "not a good metric" and that ComEd's approach more appropriately "tracks the number of dollars invested in service lines, not the number of service lines themselves" is problematic at best. Staff states that it is difficult if not impossible to assess the reasonableness of services costs in a vacuum and that it is useful to know the quantity of assets associated with particular costs. If the number of services is not provided, then the quantity or amount of assets cannot be examined alongside the spending for those assets. Without a count of the number of services, it is difficult to determine whether the dollar amounts spent on services are, in fact, reasonable. Staff Ex. 18.0 at 8-9.

Staff states that Mr. Williams' contention that unit costs for services are not important because the Company focuses on "providing service to new customers, not the 'service line' itself" and may include other costs only further confuses matters. ComEd Ex. 22.0 2nd Corr. at 7. The problem, according to Staff, is that the Company must seek specific plant additions for service costs as presented in its revenue requirement based upon the USOA, rather than on its focus on providing services to new customers based on its "data book".

Staff also takes issue with Mr. Williams' attempt to counter the unit costs developed by Staff with an alternative set of cost data that purports to show that plant costs have not increased unreasonably. *Id.* at 5. For underground lines, he presented what he terms a "real" dollar per mile figure that was derived from ComEd's annual Distribution System Data Book. According to Mr. Williams' data, the cost of underground lines has increased at approximately half the rate Staff calculated between 2000-2004 and 2005-2006; 22.6% for underground cable in duct and 25.2% for direct buried underground cable. *Id.* at 5.

Staff states there are fundamental problems with Mr. Williams' argument. He has failed to establish the relevance of the unit costs from ComEd's distribution data book for evaluating plant additions over the years 2000-2006. He does not explain why these costs provide any insights into the reasonableness of the plant additions ComEd proposes in this docket. In contrast, Staff observes that Mr. Lazare analyzed ComEd's costs by the USOA accounts which directly correspond to the Company's proposed revenue request and rates. Staff concludes that ComEd has not established why the Commission should ignore ComEd's data in ICC mandated accounts for data in a "data book" for which there is no regulatory standard and which ComEd has not connected to its accounting records.

Staff also establishes during cross examination that the figures Mr. Williams presents for the "real costs" of underground lines "are average cumulative numbers, not numbers representative of additions each year". Tr. at 758-759. Furthermore, Mr. Williams agreed that to examine the "new or additional cost" associated with the unit costs from ComEd's distribution data book, it is necessary to take the difference in the cumulative figures he presents divided by the miles of additional cable. Furthermore, Mr. Williams agreed that this would produce a unit cost of $359,000 per mile of additional cable, which is far higher than the $105,022 cumulative average mile presented in his rebuttal testimony. Tr. at 760-762

Staff contends that this discussion demonstrates that Mr. Williams used an irrelevant set of costs in his rebuttal testimony in seeking to undermine the unit costs underlying Staff's proposed adjustment. Looking at cumulative costs from one year to the next is fundamentally different from examining yearly plant additions. Thus, Staff asserts, Mr. Williams' conclusions concerning cumulative costs have no meaning for the unit costs underlying Staff's proposed adjustment for underground lines. Staff Ex. 18.0 at 6-7.

Staff also rejects Mr. Williams' arguments regarding average services costs. Mr. Williams performs an analysis that finds the unit costs for residential services increases steadily while commercial costs fluctuate depending on individual circumstances. ComEd Ex. 22.0 2nd Corr. at 7-8. Staff submits that Mr. Williams has failed to establish the relevance of this analysis in evaluating plant additions for services. The dollar amounts Mr. Williams presents for 2005 and 2006 once again do not correspond to the proposed plant additions for those years, so the meaning of his conclusions for the discussion of services costs is unclear. Staff Ex. 18.0 at 9.

Staff indicates that it takes a more reasonable approach to analyzing the trajectory of plant additions costs for underground lines and services. While Staff seeks to examine the plant additions for both underground lines and services that ComEd actually incurs, Mr. Williams presents an alternative "typical" set of costs based on different data than presented in ComEd's revenue requirement. Staff contends that Mr. Williams fails to demonstrate that these "typical" costs bear any relationship to the actual costs ComEd incurs. Consequently, the conclusions he reaches concerning these typical costs are irrelevant to determining the reasonableness of the plant additions for underground lines and services that ComEd proposes in this case.

Staff asserts that the Company's argument that Staff "has no evidence that any of these costs were imprudently incurred or unreasonable in amount" ComEd Init. Br. at 20-21 demonstrates that the Company seeks to ignore its burden of proof to establish the reasonableness of its costs and instead place the onus on Staff to prove the unreasonableness of those costs. Staff states it has clearly documented the Company's failure to support these investments. Nevertheless, in the Company's view, it is Staff's burden to prove that these unsupported numbers are unreasonable and should be removed from the Company's rate base. Staff urges the Commission to send a strong signal that ComEd must clearly demonstrate why already burdened ratepayers should be asked to pay higher rates for electric service.

Staff also asserts that ComEd's legal assertions are faulty. The Illinois Supreme Court held in *People ex rel. Hartigan v. Illinois Commerce Comm'n*, 117 Ill. 2d 120, 131-136 (1987) ("*Hartigan I*") that it is not Staff's or Intervenor's burden to proof the unreasonableness of a utility's costs in the first instance; rather it is the utility's burden to proof the reasonableness of its costs. *Hartigan I* involved a direct appeal from a circuit court order reversing a Commission order finding certain costs for Unit 1 of ComEd's nuclear power plant near Byron, Illinois ("Byron 1") to be reasonable. *Id.* at 128-130. The circuit court had also "ruled that the Commission had improperly placed the burden of proof with the Intervenors to show that Edison's costs were unreasonable, rather than requiring Edison to prove that the costs were reasonable." *Id.* at 129. The Illinois Supreme Court affirmed the circuit court's ruling, rejecting the "approach of excluding costs from the rate base only if they were proved to be unreasonable" and specifically holding that "[r]equiring intervenors to establish unreasonableness is therefore no substitute for requiring proof of reasonableness." *Id.* at 135-136.

Staff states that while *Hartigan I* focused and relied upon the burden of establishing the reasonableness of generating plant costs under what was then Section 30.1 of the Act (now Section 9-213), the Supreme Court's ruling was also based on its general reading of the Act and applies to costs other than generating plant. Specifically, after finding that the audit required by Section 30.1 replaced the presumption of reasonableness, the court found that the presumption of prudence was also invalid under the comprehensive scheme for regulation under the Act:

Staff also advises the Commission that in *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 746-747 (1st Dist. 1995) ("*Citizens*"), the holding in *Hartigan I* was clearly applied to revenue requirement components other than generating plant. Then, the court found that the utility had not met its burden of establishing the reasonableness of its capital structure and, relying on *Hartigan I*, that the burden of establishing reasonableness had been improperly imposed on Intervenors.

Staff submits that ComEd arguments criticizing Staff for allegedly failing to establish the unreasonableness or imprudence of ComEd's cost fail under the holdings in *Hartigan I* and *Citizens Util. Bd. v. Illinois Commerce Comm'n* as a matter of law.

Staff also finds ComEd's evidentiary support lacking. ComEd cites statements by Company witness Williams opining that these additions are "used and useful". However, Staff asserts, this is an unsupported conclusory opinion by a Company

employee who began his tenure in August 2006. Tr. at 764. The lack of on-the-job experience raises questions about the depth of his knowledge of the distribution system and his ability to reach conclusions about the extent to which rate base is used and useful.

While the Company does cite testimony concerning the “escalating prices of labor and materials” for underground cable and services, Staff responds that the only relevant costs presented from the cited passages are the costs of underground and overhead cables. Those increases account for grand totals of $2,600 and $2,800 in costs per mile for underground and overhead lines, respectively. ComEd Ex. 4.0, 2nd Corr. at 36-37. Staff explains, by way of example, that the Company’s average cost of 2005 and 2006 additions per mile runs to $245,170 for underground lines, Staff Ex. 5.0, Schedule 5.2 at 2, which means that the unit underground cable costs cited by Mr. Williams amount to just over one percent of these additions costs. This leaves almost 99% of these costs unexplained by the Company.

Staff asserts that ComEd’s reference to an analysis indicating that “between January 2004 and January 2007, utilities across the country experienced a 34% increase in distribution plant costs” is similarly unavailing. Missing from the Company’s argument according to Staff, is any explanation why this figure demonstrates the reasonableness of ComEd’s proposed 2005 and 2006 additions for underground lines and services. Rather, Staff suggests the fact that this industry-wide survey is the only numerical support the Company can unearth testifies to the lack of concrete evidence for ComEd’s proposed plant additions.

ComEd also cites to a statement that the Company “has controls in place to ensure that plant investments – including in cable and services – are necessary, and that the work is completed efficiently and at least cost.” ComEd Init. Br at 22. Staff responds that this statement amounts to an unsupported assurance from ComEd that its costs are reasonable. Staff also asserts that these kinds of testimonials from the Company fall short of meeting the evidentiary burden to demonstrate that costs are reasonable.

Staff submits that this discussion by the Company underscores the reasonableness of Staff’s proposed adjustment of underground lines and services. While ComEd asserts it has met its evidentiary burden, its discussion of the issue is bereft of sound evidence to support its plant additions. The only conclusion to draw from this discussion is that the Company has failed to meet its evidentiary burden and its plant additions in these areas are almost entirely unsupported. While this deficiency could justify a much larger adjustment, Staff chose instead a more limited adjustment that provides the Company reasonable increases in both materials and non-materials costs.

Staff notes that Section 9-201 of the Act specifically provides that in any hearing to determine the propriety of any proposed rate, charge, practice, rule or regulation “the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility.” 220 ILCS 5/9-201(c). Staff explains that while the burden of proof is often regarded as the burden of persuading the trier of fact on each element

of a claim, it is actually a two-pronged concept consisting of the burden of persuasion and the burden of producing evidence sufficient to make out a prima facie case. The second prong is generally referred to as the "burden of production," the "burden of producing evidence" or the "burden of going forward" on an issue. *See Consolidated Communications Consultant Serv., Inc. v. Illinois Bell Tel. Co.*, Docket 99-0429, 2001 Ill. PUC LEXIS 568, *12-14 (June 4, 2001) (explaining the two-fold nature of the burden of proof).

Staff explains that the standard for a making out a prima facie case in Illinois can generally be stated as the requirement to provide at least some evidence on every element of the underlying cause of action. *Sherman v. Cryns*, 203 Ill. 2d 264, 275 (2003) ("A plaintiff establishes a prima facie case by proffering at least 'some evidence on every element essential to [the plaintiff's underlying] cause of action.'"); *Happel v. Mecklenburger*, 101 Ill. App. 3d 107, 111 (1st Dist 1981) ("The plaintiff must have presented some evidence, more than a scintilla, on every essential element of his cause of action."). While a rate case is not a cause of action with a specific set of elements uniformly applicable in every case, Staff notes that a utility must establish "that its operating costs are reasonable, its rate base is the reasonable value of its property used for serving the public, and its rate of return on capital is the reasonable cost of the capital needed to provide the services." *Citizens*, 276 Ill. App. 3d at 746. Moreover, a utility's rate base may only include "the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers." 220 ILCS 5/9-211. Indeed, Staff notes, the Legislature has declared that one of the goals and objectives of public utility regulation is to ensure that rates for the sale of various public utility services "accurately reflect the cost of delivering those services and allow utilities to recover the total costs prudently and reasonably incurred." 220 ILCS 5/1-102(a)(iv). Thus, once specific issues are identified based on the facts and circumstances presented in a rate case, a utility is obligated to produce sufficient evidence on that issue to meet its burden of production. If a utility fails to meet this burden by producing no evidence on a specific issue, then the Commission should rule against the utility on that issue for failure to satisfy its burden of production and burden of persuasion. *Cf. Sherman,* 203 Ill. 2d at 275.

Staff argues that the flaw in the Company's argument is that it has not presented a prima facie case. As Staff views it, the Company admits it has not provided overall information on either materials or labor costs associated with plant additions. For example, Company witness Williams admits he does not know the amount of materials cost associated with the proposed 2005 plant additions for Account 366, Underground Conduit and Account 367, Underground Conductors and Devices. Tr. at 734:8-13. He also admits he has not provided for the record a breakdown of services costs between material and labor. Tr. at 740:9-18. In addition, when asked specifically about the component of plant additions represented by capitalized labor costs, Mr. Williams acknowledged, "We don't break out specifically the labor costs itself." Tr. at 738:18-19.

Staff contends these deficiencies are critical given Mr. Williams' statement that ComEd's costs to install new underground lines and new services have increased "partly due to the higher cost of materials, and partly due to the higher cost of labor."

ComEd Ex. 22.0 2nd Corr. 4. ComEd's failure to provide materials or labor costs associated with plant additions means that the prime drivers of these cost increases cannot be assessed and a finding of reasonableness for ComEd's requested increases for underground cables and services cannot be made.

ComEd further takes Staff witness Lazare to task for not making sufficient use of the available information resources in preparing his adjustment. The Company complains that Mr. Lazare visited ComEd's Springfield data room on only one occasion and notes that he did not participate in the Rate Case Field audit. ComEd also complains that during his visit to the Springfield data room Mr. Lazare "could not remember reviewing any plant addition files." According to the Company, these files included reports by a consulting firm, Power Delivery Research and Consulting Corp., which provided directly relevant information concerning the accounts Staff proposes to adjust.

Staff responds that ComEd's argument is flawed. What activities Mr. Lazare did or did not undertake in addressing the issues in this case is irrelevant to whether the Company met its burden of proof. The only relevant matter is the evidence placed on the record and whether that evidence warrants a downward adjustment in this case. The fact that ComEd wishes to discuss Mr. Lazare's lack of participation in a field audit in Chicago should appropriately be construed as an effort to divert attention away from the evidentiary record in this case. In addition, Staff asserts, ComEd provides no proof for its insinuation that the Data Room contains conclusive evidence to undermine Staff's proposed adjustments. If the reports cited by ComEd do, in fact, undermine Staff's position, then it is the Company's responsibility to make that showing. However, ComEd has failed to do so in this case.

Staff also notes that the Company's invocation of the term "real costs" refers to the fundamentally flawed cost analysis presented in Mr. Williams' rebuttal testimony that is inappropriate to use for assessing plant additions. According to Mr. Williams, the "real costs" of underground lines "are average cumulative numbers, not numbers representative of additions each year." Tr. at 758:8-759:11. Furthermore, Mr. Williams agreed that to examine the "new or additional cost" associated with the unit costs from ComEd's distribution data book, it is necessary to take the difference in the cumulative figures he presents divided by the miles of additional cable. Furthermore, Mr. Williams agreed that this would produce a unit cost of $359,000 per mile of additional cable, which is far higher than the $105,022 cumulative average mile presented in his rebuttal testimony. Tr. at 760:4-762:5. Thus, the "real costs" used by Mr. Williams are irrelevant for assessing Staff's proposed adjustment.

The Company argues that if Staff used a shorter period for its analysis, the results would produce a smaller increase in average unit costs for underground cable, thus reducing Staff's adjustment by 75%. According to the Company, "No "methodology" that produces such wildly fluctuating results based on changing a single arbitrarily chosen input can be deemed reliable." The Company goes on to state, "Albeit in a slightly different context, Mr. Lazare himself stated in his direct testimony: 'The use

of older data produces a less precise picture of the current state of ComEd's system. This can be significant since assets are being retired as well as added.'" ComEd IB, pp. 27-28.

Staff responds that the Company's arguments present a number of problems. For one, there is nothing arbitrary in the analysis performed by Staff. That analysis sought to determine the trend in underground lines and services costs over time. The larger the period of time assessed, the better the trend in costs can be assessed. As Staff witness Lazare stated, "I think that in this case a broader range is preferable to a shorter period in order to prevent any one atypical year from skewing the results." Tr. at 1751:9-12. ComEd's effort to shorten the time period arbitrarily limits the trend being analyzed.

Staff further states it is also worth noting that ComEd limits its discussion to perceived problems with the analysis for underground cable. The fact that it did not present a complementary analysis for services suggests ComEd could not derive similar favorable results by massaging the data for this cost account.

Staff contends that its proposal reflects the most reasonable assumptions about plant additions costs for underground lines and services in this case. The basis for Staff's approach is well laid out in Mr. Lazare's testimony. In contrast, the Company's proposed additions lack support or justification. In this situation, Staff argues it has presented the most reasonable approach.

(3) Commission Analysis and Conclusion

Mr. Williams and Mr. Lazare seem to make one apples-to-oranges comparison after another. These difficulties appear to be the result of insufficient information being provided to Commission Staff. The Commission notes, however, the Company's claim that it does not maintain records in the manner sought by Staff and that it has never been required to do so.

Nevertheless, ComEd bears the burden of proving that its proposed rates are just and reasonable. It is not Staff's burden or responsibility to prove that the costs at issue here are unreasonable. Inferences within ComEd's briefs that Staff must make that showing are incorrect.

Thus, the Commission orders ComEd to work with Staff to ensure that reasonably available data related to plant additions is provided to Staff. ComEd should also work with Staff to identify the availability of other data and information that Staff seeks to evaluate plant additions for electric utilities. That process shall include an analysis of the costs and benefits to electric consumers of modifying plant accounting and other utility record-keeping systems in order to provide such information. Additional relevant information that can be provided to Staff at little or no cost should be provided.

That being said, however, the Company provided justification for the increase in costs. Also, the Company effectively showed that by eliminating the most outdated information from the year 2000 from Mr. Lazare's averaging period reduced the recommended disallowance by 75%. Based on this sufficient showing, the Commission accepts an adjustment of $18,730,380 as shown on ComEd Cross Ex. 15. The

Commission finds this to be reasonable because the year 2000 data is older and much lower than more recent years.

c) Capitalized Incentive Compensation Other Than That in Section IV.B.1.b. (see V.C.1)

See Section V.C.1.

d) Customer Advances for Construction

(1) ComEd

ComEd asserts that its proposed revised rate base correctly accounted for Customer Advances for Construction. ComEd Ex. 25.0 Corr. at 21-22; ComEd Ex. 40.0 Corr. at 12-60.

ComEd notes the AG contends that rate base should be reduced for all customer advances received for the purpose of funding specific projects, regardless of whether those projects are in rate base. ComEd explains, however, that rate base should be reduced for advances only if the specific project for which the funds were provided is in rate base. Otherwise, there is no basis for imposing the AG's proposed offset. ComEd points to the uncontradicted evidence showing that: (1) these funds cannot be used to finance projects other than the projects for which they were supplied; and (2) these funds should be used to reduce rate base only if the specific projects for which they were supplied are in rate base. ComEd Ex. 25.0 Corr. at 21-22; ComEd Ex. 40.0 Corr. at 9-12.

For advances for customer requested nonstandard equipment that relate to a project in rate base, ComEd maintains that it has already made the appropriate $9.9 million total credit against plant additions in rate base. ComEd Ex. 25.0 Corr. at 22. Mr. Effron's proposed adjustment for those same advances was purely duplicative. ComEd Ex. 40.0 Corr. at 10-11. Similarly, as to AG/CUB's proposed adjustment for line extension deposits, ComEd already accepted, in order to narrow the issues, Mr. Effron's proposal to use updated 2007 values (rather than 2006), but only for those line extension deposits that relate to projects in rate base. ComEd Ex. 40.0 Corr. at 11-12. For those projects, ComEd already made the resulting credit against rate base in the total amount of $12.065 million. *Id*. The additional $10.018 million further decrease that AG/CUB sought relates to projects not in rate base because they either are non jurisdictional transmission projects or they are under construction and not yet complete. *Id*. Advances for projects not in rate base, ComEd argues, cannot properly be subtracted from rate base.

The AG, however, attempted to cloud this issue by trying to characterize the dispute as if it were about the "normal" levels of those two types of advances, rather than the actual levels, and assuming that a "normal" level is what should be subtracted from rate base. But this is not a credit that can be "normalized." That is because, whatever their "normal" levels, only advances actually made can be used by ComEd to finance projects, and the ability to use these advances as a general source of capital for ComEd is the whole basis for the subtraction. Moreover, advances already credited

against rate base cannot be subtracted again on the theory that they are part of a "normal" level of advances. Those funds cannot be counted twice.

Finally, the AG also misstated ComEd's position to imply that ComEd's position hinges on whether money has been spent or not; that is not the case. Much of the money that the AG believed is available to fund other projects has, in fact, been spent; however, the project that it relates to may still be recorded as CWIP and, therefore, not included in rate base. Accordingly, ComEd argues that the AG's proposals for further reductions to rate base lack merit and should be rejected.

(2) AG

Customer advances for construction are funds received from customers to defray the cost of construction and represent customer-supplied funds available to the utility. When the related construction is completed, these funds are either refunded to the customer or retained by the utility and credited to the cost of the plant. ComEd deducts $5,076,000 of customer advances as of a single point in time – December 31, 2006. ComEd Schedule B-15. As of December 31, 2007, the balance of these line extension deposits was $22,083,000. The AG argues that this balance should be deducted from rate base so it more closely matches the balance that will likely be outstanding during the new rate period.

In addition, ComEd receives customer advances for distribution projects that it does not deduct from rate base on the ground that they represent advances for work not yet performed. The issue here, however, is that regardless of the funds obligation, these customer advances represent cash received by the company. Tr. at 1016:12-17. Even as the work is performed, it is likely that the company will get new advances according to AG/CUB witness Effron. *See* AG/CUB Ex. 5.3. ComEd has not presented any evidence that the balance of advances as of December 31, 2006 was abnormal or unrepresentative. The twelve-month average (which avoids seasonal distortions) of the balance of distribution related customer advances -- $7,904,000 -- should be included in the total customer advance deduction from rate base according to the AG. *Id*. Including both line extension and distribution project adjustments, the total deduction from rate base for customer advances should be $29,987,000. AG/CUB Ex. 5.1, Sched. B-3.

(3) Commission Analysis and Conclusion

The AG proposes to reduce rate base to reflect cash the Company has received from customers for distribution projects. The Commission declines to adopt the AG's adjustment. The evidence shows that these funds cannot be used for projects other than those for which they were supplied. Also, the Commission notes that if a specific project is already in rate base, the Company has made the appropriate reduction.

e) Depreciable Life of Post-2006 Project

(1) ComEd

Post-2006 Project software refers to software modifications required by the end of the retail rate transition period at the end of 2006 and the "unbundling" of customer rates. ComEd Ex. 26.0 at 23-24. ComEd proposes to amortize the capital cost of this software over five years. According to ComEd, five years is the appropriate

amortization period for the Post-2006 Project software because GAAP generally requires that assets having or expected to have a useful life greater than one year be capitalized so that an asset's cost is recognized over the period of its expected use. *Id.* at 9. GAAP leaves the appropriate depreciation period to the reasonable discretion of management. *Id.* at 25. Because software typically becomes obsolete in five years, its "period of expected use" is five years, and ComEd's general policy is to depreciate those costs over that period. *Id.* at 24. Consistent with this policy and because the Post-2006 Project constitutes no exception, ComEd depreciates the Post-2006 Project software over a five-year period.

ComEd is already modifying its systems again due to the continued evolution of the retail markets. Additional modifications are also likely to be required by the elimination of the auction and ComEd's new procurement model, the implementation of the provisions of the Illinois Power Agency Act, and the provisions of Senate Bill 1299 related to utility consolidated billing and the purchase-of-receivables. ComEd Ex. 26.0 at 24-25; ComEd Ex. 40.0 Corr. at 9. ComEd operates in a dynamic and evolving environment, and its billing system enhancements will likely become obsolete in a relatively short period of time. ComEd Ex. 40.0 Corr. at 9. Thus, the five-year amortization period corresponds with the reasonably anticipated useful life of the underlying asset and is appropriate.

(2) Staff

In direct testimony, Staff witness Hathhorn proposed an adjustment to normalize ComEd's information technology ("IT") expenses and to amortize its capitalized IT costs for the Post 2006 Rate and Billing Project ("Post 2006 Project") over ten years rather than the five year amortization period that the Company proposes. Staff Ex. 1.0 at 23-32 and Schedule 1.9. In rebuttal testimony, Staff withdrew the proposal to normalize the IT expenses but maintained that ComEd's amortization expense and accumulated amortization for the Post 2006 Project should reflect a ten year amortization period. It is Staff's position that the cost of the Post 2006 Project should be amortized over the expected life of the project. The programming done for the Post 2006 Project will be in service for longer than five years, thus qualifying for an exception to ComEd's general software policy. Staff Ex. 14.0 at 15-17 and Schedule 14.8. This would reduce ComEd's amortization expense by $1,487,000, and increase its rate base for additional accumulated depreciation by the same amount.

Staff argues that the evidence in the record shows the scope of the Post 2006 Project was large in task and in dollars spent. The Post 2006 Project accounted for approximately 20% of jurisdictional Exelon Business Services Company ("BSC") IT billings for 2006. ($14.9 million (ComEd response to City of Chicago data request COC-2.25) / $78 million (ComEd Ex. 25.0 at 46)). The project is listed in ComEd's Schedule F-4 (Part 285.6100) as one of the top five additions to all of plant in service since the last rate case. ComEd Ex. 5.1 Corr. ComEd described the scope of the project in ComEd Ex. 6.0 at 9-13, which Staff summarized in direct testimony as entailing extensive modification of several existing information systems in response to ComEd's restructured retail rates, new legal requirements for those rates, and the evolution of ComEd's relationship as the regional delivery utility with the PJM regional transmission

organization. ComEd described three main components of the project, the first of which made modifications and additions to ComEd's CIMS system and to related billing and payment processing systems to comply with Docket 05-0159 (procurement case) and Docket 05-0597 (last rate case) in order to implement the new tariff structure and other tariffs such as residential rate stabilization and residential real time pricing. In this component, ComEd converted its old rates containing approximately 5,000 price combinations to its new retail tariffs that incorporate about 500 separate prices.

The second main component of the Post 2006 Project made modifications and additions to ComEd's Retail Office and PowerPath Data Mart and related systems to operate efficiently in concert with the PJM-administered markets and PJM tariffs and business practices, allowing retail customer usage to be mapped to the customer's chosen supplier and allowing ComEd to provide common usage information to all market participants. The last main component involved revisions and additions to other systems required to implement the Post 2006 Project.

It is Staff's position that ComEd's justification for application of a five year amortization period is nothing more than the rote application of its general software amortization policy. ComEd does have five other IT systems on an amortization schedule greater than five years, but four of these systems were put in service at a time when the software policy useful life was less than or equal to ten years, and another system is based upon a fifteen-year life established by the FERC. Staff Ex. 14.0, Attachment B. Thus, while ComEd does recognize that the useful life of some of its IT systems are longer than five years, it also appears that ComEd will not make a fact-based amortization determination (*i.e.*, considering the estimated useful life or magnitude of the project) that varies from its general software policy unless required to do so by regulators. Staff Ex. 14.0 at 17. Staff argues that the Commission should find the magnitude and long useful life warrant an exception to ComEd's general policy for amortization periods. Accordingly, the Post 2006 Project should be amortized over ten years rather than five.

Staff concludes that the Post 2006 Project was not of ordinary scale or scope, and it was one of the top five additions to plant in service since ComEd's last rate case. Staff recognizes that ComEd's IT system may be affected in some manner by the Illinois Power Agency. However, there is no evidence in this case of any changes on the horizon that will render the extensive programming changes implemented under the Post 2006 Project useless after five years. Staff submits that ComEd's statement that the Post 2006 Project will become obsolete in a relatively short period of time is nothing more than speculation.

(3) Commission Analysis and Conclusion

Staff emphasizes that the magnitude of the change is not likely to occur again, and thus recommends a ten year amortization. The Company emphasizes that the software will probably be obsolete in five years and therefore should be amortized over a five year period. The Commission agrees with Staff that the Company has not shown the Post 2006 Project will be obsolete in five years and accepts Staff's proposed ten year amortization period. Moreover, the magnitude and long useful life warrant an exception to ComEd's general policy for amortization periods.

2. Accumulated Provisions for Depreciation and Amortization

This issue is addressed above.

3. Accumulated Deferred Income Taxes ("ADIT")

This issue is addressed above.

D. Approved Rate Base

Based on the electric utility delivery services rate base as originally proposed by ComEd along with the conclusions *supra*, the utility rate base for ComEd approved for purposes of this proceeding is $6,694,039,000. The rate base may be summarized as follows:

Approved Rate Base
(In Thousands)

Gross Utility Plant	$ 13,022,848
Accumulated Provision for Depreciation and Amortization	-4,705,150
Net Plant	8,317,698
Additions to Rate Base	
Materials and Supplies	33,094
Construction Work in Progress	33,682
Regulatory Assets	9,432
Deferred Debits	0
Deductions From Rate Base	
Accumulated Deferred Income Taxes	-1,374,152
Non-Pension Post Retirement Benefit Obligations	-155,995
Other Accumulated Provisions for Pensions and Benefits	-39,686
Accumulated Provision for Injuries and Damages	-56,360
Accumulated Misc. Operating Provisions	-8,496
Asset Retirement Obligation	-36,195
Other Deferred Credits	-16,898
Customer Advances	-12,065
Accumulated Investment Tax Credits	-20
Rate Base	$ 6,694,039

The development of the overall electric utility delivery services rate base adopted for purposes of this proceeding is shown in the Appendix to this Order.

V. Operating Expenses

A. Overview

ComEd's delivery services operating expenses are comprised of three main categories: (1) expenses recorded in Operating and Maintenance ("O&M") Accounts under the USOA that are functionalized to the distribution function; (2) the portion of expenses recorded in other O&M Accounts that are customer-related and that are appropriately assigned or allocated to the delivery services function; and (3) the portion of expenses recorded in other USOA Accounts that are appropriately assigned or allocated to the delivery services function. ComEd Ex. 7.0 Corr. at 23-24. The last category includes items such as Administrative and General ("A&G") Expenses, Depreciation and Amortization Expenses, and Taxes.

B. Uncontested Issues

1. Storm Expense

ComEd originally proposed to set the level of storm restoration expenses in the revenue requirement at $27,119,000. ComEd Ex. 7.0 Corr. at 33, 38-39. ComEd and Staff later agreed that the revenue requirement should reflect the 2002-2007 six-year average storm restoration expenses of $26,029,000, and ComEd did so in its final revised revenue requirement. Staff Ex. 3.0 at 9-10; ComEd Ex. 25.0 Corr. at 52; ComEd Ex. 25.01, Sched. C-2, page 1, column (C); ComEd Ex. 25.02, Work Paper WPC-2.2.

ComEd and Staff agree that the revenue requirement should reflect the 2002-2007 six-year average storm restoration expenses of $26,029,000. This is reasonable and is adopted by the Commission.

2. Rate Case Expenses

a) Rate Case Expenses of the Instant Case

ComEd originally proposed to include in operating expenses $11,500,000, amortized over a three-year period, in order to recover the estimated rate case expenses of the instant case. ComEd Ex. 7.0 Corr. at 40; ComEd Ex. 7.1 Sched. C-2.9. In rebuttal testimony, ComEd provided additional support showing that the actual expenses incurred through February 29, 2008, were $6,336,510 and that the costs would increase non-ratably as the rate case progressed. ComEd Ex. 25.0 Corr. at 64-66. As of March 2008, the actual expenses increased to $7,265,513. ComEd Ex. 40.0 Corr. at 28.

Staff, however, proposed a $1 million reduction on the grounds that the Staff/ComEd joint recommendations substantially reduced the issues in the instant case. Staff Ex. 15.0 Corr. at 12-13. ComEd did not object to Staff's $1 million reduction and to amortization of the adjustment amount over three years, and reflected these adjustments in its final revised revenue requirement. ComEd Ex. 40.0 Corr. at 28-29.

According to Staff, ComEd's expenses incurred as of March 31, 2008, were $7,265,513. ComEd still projects that its rate case expenses will be $11,500,000. Because the Commission approves the joint recommendations based on the evidence

and ComEd's conditional limited waivers, the Company's full projected rate case expense of $11,500,000, less the above referenced $1 million, is approved.

b) Original Cost Audit Legal Expenses

Staff witness Griffin proposed an adjustment of $794,000 to ComEd's Original Cost Audit legal expenses, which the Company proposed to amortize over three years. Staff's adjustment resulted in a $265,000 reduction to the Company's revenue requirement. As part of the Stipulation, ComEd agreed with Staff's adjustment to reduce the annual costs associated with the original cost audit by $265,000. However, the company argues that absent the Staff/ComEd joint recommendations, the $265,000 associated with the cost should be restored to ComEd's revenue requirement. The Commission approves Staff's adjustment in accordance with the evidence in the record and ComEd's conditional limited waivers.

3. Advertising

ComEd originally proposed total recoverable advertising expenses of $613,000. ComEd Ex. 7.1, Sched. C-8. Staff witness Ostrander proposed an adjustment to disallow certain advertising expenses. The adjustment disallows expenses for print media and radio advertising that are promotional or goodwill in nature. The Company accepted Staff's adjustment. ComEd Ex. 25.0 Corr. at 67.

The Company accepted Mr. Ostrander's $180,794 adjustment to operating expenses. We agree that this is reasonable.

4. Charitable Contributions

Staff witness Ostrander initially proposed an adjustment to remove contributions to certain community organizations from the Company's miscellaneous general expenses. According to Staff, the Company substantiated that the contributions were for the public welfare and allowable under Section 9-227 of the Act. Staff has withdrawn the proposed adjustment to Charitable Contributions.

The Commission agrees with Staff witness Ostrander that the Company substantiated the contributions were for the public welfare and are, therefore, allowable under Section 9-227of the Act.

5. Lobbying

Staff witness Ostrander proposed an adjustment to remove a contribution from the Company's administrative and general expenses and reduce the Company's *pro forma* salaries and wage increase adjustment because the amounts are for lobbying activity. Section 9-224 of the Act expressly states that any amount expended for lobbying activities shall not be considered as an operating expense for determining any rate or charge.

In its rebuttal testimony, ComEd agreed to remove the $25,000 donation from its operating expenses in the revenue requirement. It also agreed to remove $9,000 related to ComEd's *pro forma* salaries and wage increase as it was related to lobbying costs. We find this to be an appropriate adjustment.

6. "Non-recurring" Expenses (AT&T Lease)

Staff witness Ostrander initially proposed an adjustment to disallow costs related to the abandonment of a real estate lease because the costs are non-recurring expenses. In his rebuttal testimony, he proposed an adjustment to amortize over a three-year period the non-recurring expenses related to the abandonment of the AT&T real estate lease.

ComEd agreed to Staff's revised adjustment to amortize over a three-year period the costs associated with the AT&T building lease abandonment charge, and ComEd reflected that adjustment in its final revised revenue requirement. ComEd Ex. 40.0 Corr. at 29-30; ComEd Ex. 40.01, Sched. RR-2, column (B); ComEd Ex. 40.02, Work Paper WPRR-1.

The Commission finds the alternate proposal to amortize this expense over a three-year period is reasonable.

7. Derivative Impact of Capitalized Incentive Compensation Not Allowed in 2005 Rate Case (See IV.B.1.b.)

There is no dispute regarding the correct calculation of the derivative impacts of the uncontested adjustment to plant discussed above in Section IV.B.1.b.

C. Contested Issues

1. Incentive Compensation Cost and Expenses

a) ComEd

ComEd argues that the Commission should permit recovery of all the costs and expenses of ComEd's incentive compensation programs for the following reasons: (1) the costs and expenses incurred under its two plans are prudently incurred and reasonable in amount; (2) they are necessary to secure and retain qualified employees engaged in the provision of utility services; and (3) they are consistent with all of the Commission's prior orders. ComEd Ex. 28.0 at 22-23; ComEd Ex. 41.0 at 7, 10-11.

ComEd maintains that Staff, the AG, CUB, and IIEC all take the position that the Commission's past Orders establish the standard that incentive compensation costs and expenses should be approved if they involve savings or other tangible benefits for customers. In ComEd's 2005 rate case, the Commission approved amounts incurred under the AIP's Total Cost goal under that standard, finding that it benefited customers and expressly rejecting Staff's argument that shareholders also could benefit from this metric. Docket 05-0597, Order at 95-97. ComEd argues that no party has identified any new or credible reason for disallowing any amount incurred under the AIP's Total Cost goal.

ComEd argues that amounts incurred under plan metrics tied to the reliability metrics SAIFI and CAIDI should also not be at issue. ComEd maintains that Staff recognized this and changed its position to support full recovery of such amounts, although IIEC and AG/CUB still proposed to disallow portions of those costs and expenses. ComEd argues that the Commission, in ComEd's 2005 and 2001 rate cases, approved full recovery of amounts incurred under such reliability metrics, and these

proposed disallowances are simply contrary to the established standards for recovery of these costs.

ComEd states that the remaining challenged amounts were not directly ruled upon in ComEd's 2005 rate case, although they include amounts incurred under the AIP's ComEd net income metric, which ComEd substituted for the former Exelon EPS metric in light of the Order in that case. Staff's and Intervenors' challenges to the amounts incurred under the AIP's net income metric, and their remaining challenges to amounts incurred under other metrics, should not be adopted. ComEd maintains that even IIEC agreed that customer benefits under the AIP's net income metric warrant allowing 50% of the amounts incurred under that metric. The amounts that Staff challenged under the AIP's net income metric are $333,000 of capitalized test year costs, $541,000 of test year operating expenses, and $88,000 of operating expenses in ComEd's *pro forma* adjustment, while IIEC opposed only half of those amounts.

ComEd argues that the evidence in this case shows that the Total Cost goal benefits customers by controlling and reducing costs and expenses. *E.g.*, ComEd Ex. 28.0 at 13-15; ComEd Ex. 41.0 at 7. ComEd states that no party submitted evidence that the metric does not benefit customers. Staff and IIEC limited their proposed disallowances to 50% precisely because their witnesses agreed that the Total Cost goal benefits customers. *E.g.*, Staff Ex. 1.0 at 13; IIEC Ex.2.0 Corr. at 61-62.

ComEd argues that IIEC attempted to equate the Total Cost goal with the former Exelon EPS metric, but that simply is not the case. The Order in the 2005 rate case, which IIEC cited here, expressly distinguished the two, allowing the amounts incurred under the Total Cost goal and disallowing the amounts incurred under the Exelon EPS metric. Docket 05-0597, Order at 96-97. ComEd notes that IIEC also pointed to Staff's testimony that reducing capital expenditures and operating expenses only benefits customers to the extent reflected in rates. ComEd maintains that the evidence is uncontradicted that the AIP's Total Cost goal was before the Commission in the last rate case and remains in the plan (at an increased percentage level, because the Total Cost goal was increased to replace the Exelon EPS metric for most employees).

ComEd explains that the net income metric benefits customers in multiple respects, including properly balancing incentives to promote reliability and safety with incentives to control expenses while maintaining ComEd's financial health and stability so that it can continue to make needed distribution system expenditures and provide reliable service. ComEd argues that the Commission should reject the proposals to disallow amounts incurred under the AIP's net income metric. In the alternative, given the strong evidence of customer benefits, the Commission should allow 50% of those amounts, as proposed by IIEC.

ComEd argues that AG/CUB's arbitrary proposal to disallow 50% of all costs and expenses incurred under the AIP is not based on the facts, is inconsistent with applicable Commission decisions, and lacks merit. ComEd maintains that speculation that future costs may change has never been a basis to disallow expenses proven during a rate case. ComEd states that the evidence in the record, as well as the Orders in ComEd's 2005 and 2001 rate cases, shows their proposal to be baseless and unlawful.

ComEd asserts that there is no basis for disallowing the amounts paid out under the LTIP's SAIFI and CAIDI metrics, which include $232,000 of capitalized costs and $978,000 of operating expenses. ComEd Ex. 25.0 Corr. at 42. The benefits to customers of reliability metrics are obvious, as recognized by Staff's and IIEC's witnesses and the Commission has recognized those benefits as warranting full cost recovery of amounts incurred thereunder in ComEd's last two rate cases. *E.g.*, ComEd Ex. 28.0 at 13; Docket 05-0597, Order at 96.

ComEd argues that it showed in detail that the other LTIP metrics also benefit customers in many respects. ComEd has also refuted the AG's claim that payments made in the form of stock compensation should be disallowed regardless of whether they are paid under a metric that benefits customers.

ComEd argues that there can be no reasonable dispute over the LTIP costs incurred under the SAIFI and CAIDI metrics ($232,000 of capitalized costs and $978,000 of operating expenses) and that the Commission should also allow all other amounts incurred under the LTIP.

ComEd states that AG/CUB's argument to disallow ComEd's pro forma adjustment to update its incentive compensation costs related to 2007 targets applied no recognized Commission standard and overlooks that customers did benefit in 2007 from the achievement of operational metrics, such as those associated with CAIDI and SAIFI.

b) Staff

Staff argues that expenses are recoverable only when the utility can prove them to be reasonable, related to utility services, and of benefit to ratepayers or utility service. The showing required by the Commission for incentive compensation costs to be included in rates fits squarely within these ratemaking principles and is reasonable, therefore the Company's arguments to the contrary must be rejected.

Staff's proposed adjustment disallows 100% of AIP costs related to the financial net income goal which primarily benefits shareholders. Staff pointed out that the Commission has repeatedly held that the cost of financial goals should not be paid by ratepayers. *See* Staff Ex. 1.0 at 18-22. In response to ComEd's argument that it changed its financial goal of Exelon earnings per share to address the Commission's concerns expressed in Docket 05-0597, Staff argued that the goal continues to be a financial goal and ComEd's revision did not change the inherent problems with recovering the costs of achieving financial goals in rates.

In response to ComEd's argument that its basis for requesting recovery of a net income component in the AIP is that ComEd executives are encouraged to align revenues and expenditures to the extent possible and to monitor and control expenses while continuing to focus on reliability and safety, Staff points out that the Commission, though, has rejected this rationalization in the past. The Commission has stated that it agrees:

> "with Staff and the AG that the earnings per share ("EPS") funding measure…should not be allowed to be recovered through rates…[T]he

> primary beneficiaries of increased earnings per share are shareholders, not ratepayers."

Docket 05-0597, Order at 96. Net income is simply an input in calculating earnings per share, and therefore confers no more benefits to ratepayers than using EPS itself. Staff Ex. 1.0 at 12. Staff's position is that the inherent problem with allowing the costs of achieving financial goals to be recovered in rates, regardless of whether those goals are those of ComEd or Exelon, is that the linkage introduces an inappropriate circular relationship between rates and the expenses such rates are designed to recover: the larger the rate increase granted the more success ComEd will have in achieving its earnings, *i.e.*, net income, goal.

It is Staff's position that ComEd failed to distinguish and demonstrate how ratepayers would benefit from a circular financial goal based on net income and that the instant case is no different from the Commission-rejected circular financial goal based on earnings per share. Staff notes that the Commission has recognized the problem with placing in rates a cost that is a reward for accomplishing a financial metric, which will be improved by simply including such costs in rates. ComEd has not addressed the fact that its net income goals are financially based and, therefore, primarily result in shareholder benefits.

Staff's proposed adjustment also disallows 50% of the cost of ComEd's Total Costs goals. This goal includes targets for O&M expenses plus capital expenditure goals. Staff's proposed adjustment disallows only half the costs of this goal to reflect the fact that it results in benefits to both shareholders and ratepayers. Staff Ex. 1.0 at 13.

Staff points out that in ComEd's last rate case, the Commission was presented with an "all or nothing" choice—allow 100% cost recovery or zero cost recovery. In this case, Staff considered that decision in its analysis and recognized, as the Commission did, that ComEd's Total Cost goal provides some benefit to ratepayers, but also recognized that the benefit to shareholders in the form of higher income between rate cases introduced an inappropriate circular relationship between rates and the expenses such rates are designed to recover.

Staff maintains that its proposal in this case to allow only 50% of the cost of the AIP Total Cost goal is a reasonable approach to a goal which results in both shareholder and ratepayers benefits, and represents an option which was not presented to the Commission in ComEd's last rate case. Staff observes that because the Commission can deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or same situation previously *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill.2d 509, 513, the Commission has the discretion to consider Staff's arguments.

Staff recommends that all jurisdictional costs of the LTIP, except for those related to operational measures such as outage duration performance and outage interruption frequency, be disallowed since ComEd cannot demonstrate benefits to ratepayers for the remaining goals. Staff Ex. 14.0 at 12.

At Staff Ex. 1.0, Attachment E, page 4, ComEd's Program Measures are presented. The regulatory/legislative goals for year-end 2007 include filing a DST (delivery services rate) case that provides for more timely recovery of prudently incurred costs. ComEd argues that, while they may be reasonable in appropriate circumstances, Staff maintains neither more frequent rate cases nor additional riders can or should be viewed as benefits to ratepayers. Rather, cost recovery acceleration implemented to meet this LTIP goal results in rate increases that occur sooner than they would have occurred without the LTIP and provide direct benefits to shareholders. Staff Ex. 1.0 at 15. In Staff's opinion, ComEd has demonstrated clearly that it does not need any additional incentive to file frequent rate cases or seek recovery of costs through riders. It is not reasonable for ratepayers to be forced to reward ComEd employees for achieving rate case or rider-recovery results that further increase the utility rates paid by ratepayers. Staff Ex. 14.0 at 14.

The remaining costs of the LTIP relate to the LTIP financial goals. Staff argues it is undisputable that the ROE/CS goal is financial in nature, as the LTIP itself identifies it as a "Financial" goal. Staff Ex. 1.0, Attachment C at 4. While goals based on financial performance may be affected by reducing expenses, such goals are clearly financial in nature and primarily benefit shareholders rather than ratepayers. In ComEd's prior rate case the Commission denied recovery of ComEd's similar request to recover costs related to EPS funding measure. Docket 05-0597, Order at 96.

The underlying issue with the ROE/CS goal is that it is financially based. The use of a higher ROE in setting rates results in a higher, not lower, cost to ratepayers. Further, any change in the capital structure will affect the rate of return approved in this case; therefore, once again the goal is tied to financial results which cannot be separated from the cost of achieving the goal itself. If the Commission includes incentive compensation in rates for this goal, it will contribute to ComEd's higher return, and ratepayers are assured of no benefits from the cost of the incentive compensation. Staff Ex. 14.0 at 13-14.

Staff responds that its adjustment to the LTIP is not based on *any* goals related to accomplishment of reliability metrics. Staff's adjustment relates solely to the one-third of the LTIP based upon financial goals and another one-third based upon legislative and regulatory goals.

Staff's concern is not with appropriate and timely recovery of prudent costs, but rather that under the goals of the LTIP ratepayers would pay an incentive to ComEd to file more frequent rate cases, or to achieve results in those rate cases more favorable to ComEd, which in turn does nothing to benefit ratepayers. Staff submits that ComEd has not provided this Commission with any evidence that ComEd's LTIP legislative and regulatory goals, which essentially reward ComEd for filing rate cases and proposing new rate riders, benefit ratepayers.

c) AG

AG/CUB witness Effron proposes three adjustments to ComEd's request to recover $18,343,000 of incentive compensation: (i) the elimination of the pro forma adjustment to increase incentive compensation for 2007 targets, (ii) the elimination of

incentive compensation related to financial goals, and (iii) the elimination of all stock-based compensation. These eliminations result in a total adjustment to incentive compensation expense included in the Company's revenue requirement of $17,868,000. AG/CUB Ex. 5.1, Sched. C-2.

As noted by Staff witness Hathhorn, the main consideration affecting rate recovery of incentive compensation is whether the goals and costs "confer upon ratepayers specific dollar savings or other tangible benefits." Staff Ex. 14.0 at 13. The AG and Staff agree that if the Commission allowed ComEd's proposed pro forma adjustments that increase incentive compensation to reflect 2007 targets, ratepayers would pay for benefits that they did not get in the test year. Staff Ex. 1.0 at 9.

The AG also points out that ComEd's LTIP is still based upon the same financial goal – an "EPS goal – which the Commission rejected in Docket 05-0597. The AG agrees with Staff witness Hathhorn, who states that the "mere fact that the goals relate to ComEd, as opposed to Exelon, is irrelevant" since the ComEd specific goals in and of themselves do not "confer upon ratepayers specific dollar savings or other tangible benefits." Staff Ex. 14.0 at 13 (quoting from Commission orders in dockets 05-0597 at 96, 04-0779 at 44, 03-0403 at 15). The AG states that even after ComEd's programs were revised in 2007 to address the Commission's concerns as stated in Docket 05-0597, these revisions were not in place in 2006, and would not be reflected in 2006 test year costs.

Following this same reasoning, stock-based compensation in the form of performance shares and stock options should be eliminated according to the AG. The AG states that the form of this compensation by itself creates an incentive to maximize the Exelon stock price without regard to whether the maximization of the price of the stock is in the best interest of ratepayers. If company management is successful in increasing the price of Exelon stock, company shareholders should be gladly willing to absorb the cost associated with this incentive compensation.

d) CUB

CUB contends that ComEd has not provided any evidence that its incentive compensation program confers upon ratepayers specific dollar savings or other tangible benefits. Nor has the Company demonstrated that its incentive compensation plan has reduced expenses and created greater efficiencies in operations. Therefore, CUB argues that Mr. Effron eliminates incentive compensation and reduces *pro forma* test year expenses by $18,141,000. AG/CUB Ex. 2.0, Sch. C-2.

CUB states it is well established that the Commission has generally disallowed recovery of incentive compensation costs except where the utility has demonstrated that its plan has reduced expenses and created greater efficiencies in operations. *See* Dockets 06-0070, 06-0071, 06-0072 (Cons.); 05-0597; 03-0403; 97-0351 and 95-0219. CUB maintains that there is nothing in this record that demonstrates the incentive compensation plan proposed by ComEd reduces expenses and creates greater efficiencies.

CUB argues that ComEd's incentive compensation plan linking incentive compensation to the financial goals of ComEd's parent causes a circular relationship

between rates and the expenses that such rates are designed to recover. CUB maintains that this is contrary to the goals of the ratepayer, which are to minimize expenses and use energy efficiently, and benefits the shareholders but not the ratepayers, who will be forced to reward the Company for earning money for the shareholders and charging them higher rates.

CUB states that in order to recover incentive compensation expenses from ratepayers, prior cases required the utility to prove that its incentive compensation plans benefited ratepayers if they were tied to a financial component. For instance, in Docket 05-0597, CUB claims the Commission found that "the incentive compensation payments are linked directly to reduce Operations and Maintenance ("O&M") costs and thus an increase in earnings will not trigger any incentive compensation payments. In other words, CUB asserts that increased earnings are a potential result, but not a necessary result of reduced O&M expenses." Docket 05-0597, Order at 96.

CUB states that under ComEd's proposal, ratepayers pay the cost of the incentive compensation plan irrespective of whether the Company or its parent company achieves its financial goals and incentive compensation payments are made. AG/CUB Ex. 2.0 at 18. CUB affirms that there is no mechanism to refund that cost to ratepayers should the Company not achieve its expected goals. CUB argues the incentive compensation plan should be rejected because under the circumstances of ComEd's incentive compensation plan, consumers might not benefit for several reasons.

CUB claims, given that ComEd could always change its incentive compensation goals or fail to meet these goals in the future, the Commission should find that the incentive compensation costs are not reasonably or prudently incurred and reject the incentive compensation plan. CUB asserts that the Company's incentive compensation plan relies heavily on the parent Company reaching certain financial goals without any showing that the plan has reduced expenses or created greater efficiencies in operations. Additionally, CUB argues that ComEd might not achieve its financial goals, or the goals might change, resulting in no payments to employees. CUB affirms that the incentive compensation plan only benefits shareholders and there is no way for ratepayers to receive a refund if no payments are made under the plan. Consistent with prior cases, CUB recommends that the Commission should exclude the cost of ComEd's incentive compensation plan from ComEd's revenue requirement.

e) IIEC

For ComEd's AIP, IIEC recommends that 100% of the costs attributable to payments based on the AIP's CAIDI, SAIFI, OSHA and Other goals be allocated to ratepayers. These program goals relate directly to service reliability, service quality and employee safety. IIEC says that the primary beneficiaries of these incentives are ComEd's customers.

However, according to IIEC, the distinct AIP goals of Total Costs and Net Income benefit both the ratepayer and investor. Accordingly, given the difficulty of determining precise benefit splits IIEC says its witness made judgmental apportionment of the costs

attributable to those goals. IIEC therefore, recommends that the costs of these program components be shared -- 50% to investors and 50% to ratepayers.

IIEC says ComEd's LTIP is designed to specifically align management executives' interests with those of utility shareholders, not utility customers. Consequently, because the LTIP benefits primarily shareholders, IIEC recommends that shareholders be responsible for 100% of the costs of the LTIP incentive compensation program.

In response to comments in subsequent testimony from ComEd, IIEC's witness revised his calculation of the appropriate adjustment amounts, *inter alia*, to properly distinguish the expense and capital effects of his recommendations on ComEd's revenue requirement. IIEC says the incentive compensation cost responsibilities (percentages) determined for each component of ComEd's AIP and LTIP remain unchanged from the initial IIEC analysis.

f) Commission Analysis and Conclusion

As stated in Docket 05-0597, the parties agree on the standard that the Commission should apply when deciding whether to allow a utility to recover the cost of its incentive compensation program. Docket 05-0597, Order at 95-96. The utility can recover its expenses when it can prove that the expenses are reasonable, related to utility services, and of benefit to ratepayers or utility service. The issue of disagreement amongst the parties is whether ComEd's incentive compensation plan provides benefits to ratepayers.

Regarding ComEd's AIP's Net Income Metric, the Commission agrees with Staff's proposed adjustment disallowing 100% of AIP costs related to the financial net income goal which primarily benefits shareholders. ComEd's net income goals are financially based and primarily result in shareholder benefits. The Commission has repeatedly held that the cost of financial goals should not be paid by ratepayers.

We agree with ComEd regarding its Total Costs goals. The Commission found as much in Docket 05-0597, Order at 96-97, and we see no reason to waiver.

ComEd's Long-Term Incentive Plan should be adjusted as well to reflect Staff's suggestions relating to the one-third of the LTIP based upon financial goals and another one-third based upon legislative and regulatory goals. We note Staff's concern that under the goals of the LTIP ratepayers would pay an incentive to ComEd to file more frequent rate cases, or to achieve results in those rate cases more favorable to ComEd, which in turn does nothing to benefit ratepayers. Staff Init. Br. at 40. Staff submits that ComEd has not provided this Commission with any evidence that ComEd's LTIP legislative and regulatory goals, which essentially reward ComEd for filing rate cases and proposing new rate riders, benefit ratepayers.

2. Uncollectibles Expenses (Derivative Adjustment)

All proposed adjustments to uncollectibles expenses are derivative impacts of one or more other proposed adjustments discussed elsewhere.

3. Merger Expenses

a) ComEd

ComEd's revenue requirement does not include any expenses related to the planned merger between Exelon and PSEG. ComEd incurred non-incremental merger costs and included them in its revenue requirement because these costs are not actually merger-related. ComEd Ex. 7.0 Corr. at 39; ComEd Ex. 7.1, Sched. C-2.3.

In response to inquiries from Staff and arguments from AG/CUB that these costs should be disallowed, ComEd explained that: (1) employees who worked on the merger are salaried employees who remained responsible for their normal utility duties and completed their merger related duties by effectively working unpaid overtime; (2) ComEd does not pay salaried workers for overtime, so there is no sound business reason to make them record the total number of hours they worked; and (3) ComEd wanted to record hours devoted to the merger. ComEd Ex.25.0 Corr. at 54-56; ComEd Ex. 40.0 Corr. at 24-25. Thus, hours that would have otherwise been assigned to normal utility duties that were still being completed, were instead assigned to the merger.

The AG incorrectly sought to disallow $2.546 million in non-incremental salary and wage expenses for employees who, during 2006, not only performed all of their usual and ordinary delivery service functions for ComEd but also performed additional services in connection with the abandoned Exelon-PSEG merger. AG Init. Br. at 15-16. ComEd asserts it showed that the AG's proposal has no merit. Staff, which once took the same position, no longer did so after reviewing the facts and evidence that ComEd presented. During 2006, ComEd required certain salaried employees to assist in preparing for a planned merger between Exelon and PSEG. Those employees effectively worked unpaid overtime to carry out merger work in addition to their normal duties. In its record keeping, ComEd accounts for 40 hours of regular time, but does not separately record overtime hours worked for salaried employees. ComEd did, however, ensure that time spent working on merger-related activities was accurately recorded. This resulted in an undercount that ComEd witnesses Houtsma and Frank referred to as part of ComEd's "non-incremental" merger costs because it comprised salary and related benefit costs for employees who were still performing in full their normal duties in support of the utility, and has nothing to do with the merger. ComEd Ex 25.0 Corr. at 54-56; ComEd Ex. 40.0 Corr. at 24-25. Thus, disallowing these costs would be improper and would prohibit ComEd from recovering the full costs of its labor force responsible for performing utility functions during the test year.

Unlike Staff, ComEd argues that the AG did not comprehend that the amounts ComEd seeks to recover here were spent to pay salaried employees who provided full-time service to the utility in furtherance of its distribution-related functions. Failure to allow ComEd to recover this $2.546 million would be an unlawful disallowance of normal and reasonable employee costs actually incurred for employees performing regular distribution related duties.

In 2006, ComEd's customers got a full day's work for a full day's pay from those employees whose salary and wage expense is included in the revenue requirement,

and which the AG seeks to disallow in part. Moreover, these test year expenses are fully representative of the services that those employees will perform once the rates that are the subject of this case go into effect. ComEd Ex. 25.0 Corr. at 56. As such, they are legitimate and allowable utility expenses and the AG's proposed adjustment lopping off a part of those expenses should be rejected.

b) Staff

In direct testimony, both Staff and the AG recommended a disallowance for adjustments to ComEd's rate base and operating expenses for salary, benefits, payroll taxes, and incremental costs related to the defunct merger of Exelon with PSEG. ComEd proposed, in its Schedule C-2.3 to remove the incremental costs of the Exelon/PSEG merger. Upon reviewing additional testimony and discovery responses, Staff withdrew its adjustment. However, the AG still reflects the adjustment in its rebuttal position.

c) AG

The AG argues that the Commission should eliminate all expenses associated with the proposed merger of Exelon Corporation and PSEG, not just the "incremental" expense adjustment proposed by ComEd which reduced test year operation and maintenance expenses by $5,281,000. ComEd Ex. 7.0 Corr. at 39. ComEd's adjustment does not eliminate the salary and benefits of employees who spent time on merger related activities in 2006. To the extent that these employees' time was devoted to merger related activities, the AG states that it was not incurred in the provision of utility service in the test year, and therefore should not be included in the Company's revenue requirement.

ComEd's reason for not removing the merger related salaries and benefits expenses is that the time of those employees subsequent to the test year will be spent performing utility related duties. AG/CUB Ex. 2.0 at 16 (response to Staff Data Request DLH-2.01). However, the AG argues that it is unclear how much time these employees will spend performing utility related duties. ComEd asserts that certain employees performed merger related work in addition to their usual duties and that by eliminating the wages and benefits of those employees, the Commission will understate the Company's cost of service. If this is true, then the AG states that it means that ComEd employees performed any merger work for free – which in turn means no costs should have been assigned to that work. Even assuming then that it is known how much time employees will spend subsequent to the test year on utility-related duties, it is also possible that it would reduce the time – and the cost – of other employees performing such duties.

What is known is that ComEd did assign costs to the merger related work performed by the employees. As those costs do not relate to the provision of delivery services, they should not be included in the delivery services revenue requirement. The effect of eliminating merger-related salaries and benefits is to reduce pro forma test year operation and maintenance expense by $2,546,000. AG/CUB Ex. 5.1, Sched. C-2.

d) CUB

CUB states that the Company argues that it reduced test year operational and maintenance expenses by $5,281,000.00 to eliminate costs incurred in connection with the merger of Exelon and PSEG. AG/CUB Ex. 2.0 at 16. However, CUB states that AG/CUB witness Effron testified that the Company did not in fact eliminate the full amount of merger costs in connection with the merger, it only eliminated "incremental costs." *Id.* at 16. For instance, CUB recognizes that the salaries and benefits of employees who spent time on merger related activities were deemed not to be incremental and were excluded from adjustment. CUB argues that the time spent on merger activities in the test year is not necessary for utility service, and the cost of that time should not be recovered from ratepayers. CUB avers that the effect of eliminating merger related salaries is to reduce pro forma test year operational and maintenance expenses by $2,546,000.00. *Id.* at 17.

CUB states that ComEd witnesses Houtsma and Frank claim that certain employees performed merger related work in addition to their usual duties and that eliminates any of the wages and benefits of those employees which will understate the Company's cost of service. AG/CUB Ex. 5.0 at 26. CUB recommends that this argument be rejected because what the witnesses seem to be saying is that those employees performed the merger work for free, then as a result, no cost should be assigned to that work. However, CUB recognizes that ComEd did assign costs to the merger related work performed by the employees. CUB argues that since those costs do not relate to the provision of delivery services, they should not be included in the delivery services revenue requirement.

CUB asserts that since merger accounting requires that assets and liabilities be stated at their fair value at the time of the merger, thus accelerating the recognition of the cumulative effect of actuarial gains or losses, ComEd should have recorded a regulatory liability to offset the recognition of the actuarial gains at the time of the merger.

e) Commission Analysis and Conclusion

The Company maintains that no adjustment should be made to reflect the salaries and benefits of employees that performed merger-related activities because all such work was unpaid overtime. The question remains, however, whether these same employees would have performed unpaid overtime on delivery service test year activities if not for the merger. Also, it is not clear that the expenses claimed by the Company are representative because of the merger work. However, not all of the costs should be disallowed as proposed by the AG and CUB because these employees performed delivery service work as well. Accordingly, one quarter of the pro forma test year adjustment proposed by the AG is granted.

4. Administrative and General ("A&G") Expenses

a) Exelon Way Severance Amortization

(1) ComEd

In its 2005 rate case, the Commission approved recovery of Exelon Way severance costs (approximately $158 million) by amortizing them over a 7½ year period. Docket 05-0597, Order at 86-90; Docket 05-0597, Order on Rehearing at 4 (Dec. 20, 2006). Accordingly, ComEd included $18,792,000 of those amortized costs in its 2006 test year operating expenses. ComEd Ex. 7.1, Sched. C-5, page 2, line 4.

Despite the Commission's Order in Docket 05-0597, AG/CUB attempt to relitigate the matter in this Docket. AG/CUB witness Effron argues that because the Commission's 05-0597 Order did not expressly direct ComEd to create a "regulatory asset" for the purpose of recovering its amortized costs, those costs cannot be recovered. AG/CUB Ex. 2.0 at 22-23; AG/CUB Ex. 5.0 at 27-29. ComEd explains that this argument ignores the clear meaning of the Commission's Order in Docket 05-0597 to provide for recovery of Exelon Way severance costs over a 7½ year period. ComEd Ex. 40.0 Corr. at 25. It was clear in Docket 05-0597 that ComEd sought recovery of the full amount of the "initial" Exelon Way severance costs of approximately $158 million over that period. ComEd Ex. 40.03; Docket 05-0597, Order at 86. The Commission fully understood that ComEd was seeking to amortize the full amount of these costs: "ComEd's proposed operating expenses include an appropriate level of severance expense, including an amortized level of the Exelon Way severance expenses." Docket 05-0597, Order at 86. Further, the Commission cited 83 Ill. Adm. Code § 285.3215 in its Order in Docket 05-0597: "[T]he record establishes that ComEd properly seeks recovery of its initial severance costs for a program expected to produce hundreds of millions of dollars in savings over the life of these rates. Mr. Effron's proposed adjustment would deny ComEd any recovery of that cost, which removes the incentive created by Section 285.3215 to initiate such programs." Docket 05-0597, Order at 90 (July 26, 2006). Were ComEd seeking only to recover its 2004 test year costs for the Exelon Way Severance program, ComEd would have no need to cite, and the Commission would have no need to rely upon, Section 285.3215, and the Order in Docket 05-0597 would not have referenced an "amortized level" of severance expenses. Staff witness Hathhorn made clear during cross-examination that the Commission's 05-0597 Order authorized ComEd to recover its amortized costs. *See* Tr. at 650-654; *see also* Staff Ex. 14.0 at 17-18.

(2) AG

The AG argues that the Commission should reject ComEd's claim that the Commission authorized the establishment of a regulatory asset consisting of Exelon Way severance costs. While the company properly includes its actual 2006 severance costs of $294,000, the proposed $18,791,000 pro forma adjustment reflects Exelon Way severance costs that were incurred in the years 2003 and 2004. ComEd Schedule 11.3. ComEd claims that in Docket 05-0597 the Commission authorized establishment of a regulatory asset of $158 million to be amortized over 7½ , with 89.2% of the annual

amortization to be included in jurisdictional expenses. ComEd Ex. 25.0 at 57 (*citing* Docket 05-0597, Order at 90). AG/CUB witness Effron claims that ComEd's inclusion of $18,791,000 of Exelon Way severance costs is improper because he believes the Commission did not authorize a regulatory asset and subsequent amortization in Docket 05-0597.

The AG points out that the Order on which ComEd relies does not create a 7½. year amortization period – in fact, does not even use the terms "regulatory asset" or "amortization" – in its discussion of Exelon Way severance costs. Docket 05-0597, Order at 89-90. Although the Commission did allow inclusion of approximately $18.8 million of Exelon Way severance costs in jurisdictional operation expenses in Docket 05-0597, the expense reflected the actual costs incurred in the 2004 test year. Docket 05-0597, Order at 89-90. There was testimony in that case that the actual costs incurred in 2005, $21 million on a total company basis, "results in an implied amortization period of over seven years ($158 million divided by $21 million = 7½ years)." Docket 05-0597, Order (*citing* ComEd Ex. 19.0 Corr. at 46). There is no mention of a formal request by ComEd to defer costs related to the Exelon Way program incurred in 2003 and 2004 or to amortize those costs prospectively for ratemaking purposes.

A regulatory asset can be recorded if it is "probable" that future revenues at least equal to the capitalized cost will result from inclusion of that cost in prospective revenue requirements. According to the AG, nothing in the analysis and conclusion on this issue in Docket 05-0597 can reasonably be interpreted to have created such a probability of such recovery. Therefore, the proposed pro forma adjustment related to Exelon Way severance costs should be eliminated and pro forma test year operation and maintenance expenses reduced by $18,791,000. AG/CUB Ex. 5.1, Sched. C-2.

(3) CUB

CUB agrees with the AG.

(4) Staff

Staff agrees with ComEd that there is no pre-requisite that the Commission must have specifically directed ComEd to create a regulatory asset associated with the recovery of its Exelon Way severance costs. This accounting treatment was necessary to reflect the Commission's conclusion to allow ComEd to amortize the costs over a 7½ year period. If no regulatory asset was established, ComEd would have no record of the unamortized costs on its books. Staff agrees with ComEd that Mr. Effron's adjustment is an incorrect interpretation of the Commission's prior order from an accounting perspective and should not be adopted.

(5) Commission Analysis and Conclusion

We agree with Staff and the Company that it was appropriate and necessary to create a regulatory asset to reflect the Commission's decision in Docket 05-0597. Accordingly, Mr. Effron's adjustment is not adopted.

b) Accounts 920-923

(1) ComEd

ComEd submitted testimony showing that its original proposed revenue requirement appropriately included $341.301 million of administrative and general ("A&G") expenses, including the applicable amounts in Accounts 920-923. ComEd Ex. 7.0 Corr. at 26-31; ComEd Ex. 7.1, Sched. C-1; ComEd Exs. 7.3, 7.4; ComEd Ex. 8.0 at 2, 5-7; ComEd Ex. 8.2; ComEd Ex. 4.0 2nd Corr. at 67-68.

ComEd asserts that it showed there is no merit to the claim of AG/CUB witness Effron that growth in A&G accounts 920-923 has been "substantially in excess of the expense growth that can be explained by normal inflation," and ComEd has not "entirely" explained this growth to his "satisfaction", hence, there should be a disallowance of $12.680 million. AG/CUB Ex. 2.0 at 28; AG/CUB Ex. 5.1, Sched. C-2.1. According to ComEd, Mr. Effron ignored essentially all of ComEd's evidence.

The AG claims that the Commission did not focus on those particular accounts in ComEd's last rate case, Docket 05-0597, and thus the Commission did not actually reject this inflation approach in that Docket. ComEd argues, however, that the AG mischaracterizes what the Commission did in fact do in that case.

The Commission, in its Order in Docket 05-0597, limited ComEd's overall increase in A&G expense to an inflation adjustment on the grounds that ComEd had not provided, in that case, a satisfactory explanation for the above-inflation rate increases. However, the AG completely ignored that, on rehearing, ComEd supplied substantial additional information describing the reasons for the increases in its A&G costs, and the Commission in its Order on Rehearing accepted that explanation and approved most of ComEd's actual A&G costs for recovery. Docket 05-0597, Order on Rehearing at 49-51 (Dec. 20, 2006).

In presenting its direct case in this docket, ComEd uses the Commission's action on Rehearing in Docket 05-0597 as the template to follow. ComEd maintains that the evidence it presented in its original filing in this case reveals that ComEd presented here at least as much information, in fact more, as it presented on rehearing in Docket 05-0597. The level of detail presented by ComEd in its direct testimony was more than equivalent to the level of detail that ComEd presented on rehearing in Docket 05-0597. In her testimony on rehearing in that case, Ms. Houtsma presented a table comparing the increases in A&G costs approved in ComEd's prior rate case (Docket 01-0423, with a 2000 test year) with the 2004 test year costs in Docket 05-0597. *See* Docket 05-0597, Order on Rehearing at 30 31, et seq.. In addition, the BAH report, which AG/CUB failed to address, presents an unprecedented level of detail regarding ComEd's total A&G costs. Finally, in discovery and in rebuttal testimony, ComEd describes the specific factors (including charitable contributions, facilities relocation, information technology costs, and training) that increased the three A&G Accounts that Mr. Effron claimed were not explained. E.g., ComEd Ex. 25.0 Corr. at 58-59; *see also* Tr. at 576-579 and ComEd Cross Ex. 3.

By seeking a disallowance on the grounds that ComEd simply did not "sufficiently explain" (that is, to his satisfaction) the increases, Mr. Effron overlooked that the

explanation of the increase ComEd provided was more than compliant with the level of detail the Commission had found sufficient only nine months before ComEd filed this case. According to ComEd, once the utility presents its prima facie case of the costs needed to provide service, the burden of going forward with the evidence shifts to other parties to show that the costs are unreasonable because of inefficiency or bad faith. *Illinois Bell Tel. Co. v. Illinois Comm. Comm'n*, 372 Ill. App. 3d 769, 776 (3rd Dist. 2002); *City of Chicago v. Cook County*, 133 Ill. App. 3d 435, 442-43 (1st Dist. 1985).

Mr. Effron never identifies any single expenditure in any of the Accounts 920-923 as perhaps imprudent or excessive. Having received a number of data request responses on the subject, Mr. Effron states nothing further about Accounts 920-923 in his rebuttal testimony. Tr. at 579-580; ComEd Cross Ex. 3. In fact, Mr. Effron affirmatively testified that he did not identify any costs that he was challenging on either "prudence" or "reasonableness" grounds. Tr. at 574-576.

(2) AG

The AG states that A&G expenses include costs charged to FERC Accounts 920 – 935. Accounts 920 – 923 include salaries, wages, and related expenses of officers and employees that are not directly associated with the transmission, distribution, or customer service operations of the system (Accounts 920 – 922) and outside services expense (Account 923). Taken together, these accounts reflect those A&G expenses that are related to ComEd's actual administrative operations and exclude those A&G expenses more properly evaluated individually.

The AG argues that ComEd's proposed test year expense level – significantly higher than any historical record – should be rejected. Before any adjustments, ComEd charged a total of $201,589,000 to Accounts 920-923 in 2006. ComEd Schedule C-4 at 5. In 2004, expenses charged to those same accounts were $180,248,000. AG/CUB Ex. 2.0 at 27. In 2005, expenses charged to those same accounts were $158,121,000. Total expenses charged to these accounts for 2007 are not yet available; however, through the first nine months of 2007, ComEd charged $140,648,000. This translates into an annualized expense level of $187,579,000.

According to the AG, a reasonable basis for calculating a normalized level of expenses in this case is to use the Commission's final order in Docket 05-0597. In that case, the Commission allowed $125,835,000 of expenses charged to Accounts 920 – 923, excluding Exelon Way severance costs, in the Company's jurisdictional revenue requirement. In the present case, the Company includes pro forma jurisdictional expenses of $161,727,000 in Accounts 920 – 923, again excluding Exelon Way severance costs. Thus, the expenses in the present case exceed the expenses in Docket 05-0597 by $35,892,000, or approximately 28.5%. This is substantially in excess of the expense growth that can be explained by normal inflation in the two years from 2004 to 2006 according to the AG. To the extent this increase has not been satisfactorily explained, the AG urges the Commission to adjust pro forma expense levels.

Taking the level of A&G expenses allowed in that instance, adjusting for inflation in the two years from the 2004 test year in that case to the 2006 test year, adjusting for

the reclassification of expenses as proposed by ComEd, and including the proposed elimination of merger costs and incentive compensation (as discussed above) results in a jurisdictional revenue requirement in the present case of $156,796,000 in expenses charged to Accounts 920 – 923. That amount is $12,408,000 greater than the level of expenses allowed by the Commission in Docket 05-0597, as adjusted. AG/CUB Ex. 1.1, Sched. C-2.1. Unless the Company can justify the growth in those A&G expenses from 2004 to 2006 and can establish that the expenses incurred in 2006 are representative of the expenses that will be incurred prospectively, the A&G expenses included in the Company's delivery services revenue requirement should be reduced by this amount according to the AG.

Both ComEd and Staff reject this approach as reflecting a position "that inflation factors are more appropriate than ComEd's actual costs," (ComEd Ex. 40.0 at 26), or "calculated in a manner rejected by the Commission in the last case," (Staff Ex. 15.0 at 18). AG/CUB witness Effron's testimony focuses on the unexplained increase in costs, which cannot be attributed to inflation alone, and which is not attributed to any other specific items. Mr. Effron's adjustment for inflation results in a growth of $6,472,000. AG/CUB Ex. 2.0 at 29. The AG states that the Commission never rejected this approach in the prior ComEd rate case (Docket 05-0597) and no party in that case proposed that A&G Accounts 920 through 923 be examined together, or made a comparison between charges to those accounts from one test year to another. Accounts 920 through 923 were examined, but in the context of reviewing ComEd's proposed functionalization, corporate governance and Exelon BSC expenses. Docket 05-0597, Order at 60, 68, 72, and 77. The Commission noted the same concerns raised by Mr. Effron in this proceeding as a reason to find "unpersuasive" ComEd's requested inclusion of $260,909,000 administrative and general expenses. The AG states that the Commission should reject similar unexplained increases in A&G expenses, and accept the AG's proposed elimination of $12,680,000 in A&G expenses from the ComEd revenue requirement.

(3) Staff

Staff does not support AG/CUB witness Effron's proposed adjustment to accounts 920-923. AG/CUB Ex. 2.0 at 25-30. Mr. Effron claims that it is appropriate to analyze Accounts 920-923 together since these expenses relate to the actual administration of the operations of the Company, as opposed to account 926 for pensions and benefits. He asserts that ComEd has not satisfactorily explained the increase in these A&G accounts and that they should be adjusted based on the amount approved in Docket 05-0597, with certain adjustments for inflation. In Staff's opinion, it appears Mr. Effron's adjustment is calculated in the manner rejected by the Commission in the last case; therefore, Staff does not believe it would be appropriate for the Commission to adopt the adjustment in this case. Staff Ex. 14.0 at 18-19.

(4) Commission Analysis and Conclusion

The Company provided extensive evidence to support its costs. We agree with Staff and the Company that Mr. Effron's proposed adjustment is the same type of

inflation-based adjustment that the Commission rejected on rehearing in Docket 05-0597. Accordingly, no adjustment to the Company's accounts 920-923 costs is necessary.

c) Rate Case Expenses

(1) 2005 Rate Case Expenses Amortization

(2) 2005 Rate Case Expenses in the 2006 Test Year

(3) 2005 Rate Case Rehearing Expenses in the 2006 Test Year

(a) ComEd

In ComEd's 2005 rate case (Docket 05-0597), the Commission allowed the recovery of approximately $7.5 million of expenses, amortized over three years. In accordance with that order, ComEd included $2.438 million in its operating expenses. ComEd Ex. 7.1, Sched. C 2.14.

ComEd argues that AG/CUB's proposed disallowance would improperly disallow amounts previously approved by the Commission in Docket 05-0597. ComEd Ex. 25.0 Corr. at 60-61. To accept this disallowance would deprive ComEd of recovery of costs that everyone accepts were prudently incurred, and, moreover, to do so would be contrary to the Commission's determination of this exact issue in ComEd's 2001 rate case (Docket 01-0423), where the Commission affirmed its finding of rate case expenses incurred in ComEd's 1999 rate case (Docket 99-0017) and allowed ComEd's rate base to reflect recovery of the prior 1999 rate case expenses. *See* ComEd 01-0423, Order at 122. In addressing the same issue in the Interim Order in the 01-0423 Docket, the Commission stated: "Under the terms of Section 16-108 of the Act, the Commission is obligated to permit an electric utility to recover its costs associated with delivery services." Docket 01-0423, Interim Order at 111.

The AG complains that if ComEd is allowed to recover these expenses, it will be recovering portions of two sets of rate case expenses, *i.e.*, from this docket and the unrecovered portion of the approved costs from Docket 05-0597. The AG does not, however, identify why recovery of both types of expense goes against Commission rules or established ratemaking principles. Moreover, in Docket 05-0597, the Commission specifically approved recovery of ComEd's approved rate case expenses over an amortization period that has not yet ended. To disallow these costs now contravenes the Commission's order in that case. Moreover, unless both of these expenses are recovered in the revenue requirement, ComEd will be unlawfully denied the opportunity to recover prudently-incurred costs.

The AG also argues that unrecovered costs of Docket 05-0597 should be disallowed because of a hypothetical chance that ComEd might over-recover these expenses. All rates are based on what is known as of the time they are set. It is illogical and unlawful to claim that the chance of over-recovery is grounds for building into rates a mechanism that guarantees under-recovery of previously approved expenses. Moreover, this argument ignores that the Commission does not allow the utility to recover carrying charges on rate case expenses, even though recovery is

spread over a multi-year period. ComEd states that this further diminishes any risk of over-recovery and underscores how unfair further disallowances would be.

With respect to 2005 rate case expense incurred in the test year in connection with Docket 05-0597, and before rehearing in that case was granted in September 2006, ComEd incurred costs of $2.986 million that were not included in the $7.5 million in costs discussed in the preceding section. ComEd maintains that these amounts are properly recoverable rate case costs. ComEd proposed to amortize the $2.986 million over three years, resulting in the inclusion of $995,000 in the revenue requirement. ComEd Ex. 25.0 Corr. at 61-63.

Contrary to AG/CUB and Staff's proposals to disallow recovery of these expenses, the proposed amortization is not an exercise in "retroactive ratemaking." ComEd Ex. 25.0 Corr. at 63. AG/CUB and Staff cited no Commission Order holding that inclusion of test year operating expenses in the revenue requirement somehow constitutes retroactive ratemaking. While the Illinois Supreme Court has interpreted the Act to forbid retroactive ratemaking, retroactive ratemaking is defined in certain contexts as a prohibition on "refunds when rates are too high and surcharges when rates are too low." *BPI v. Illinois Commerce Comm'n*, 136 Ill. 2d. 192, 209; 555 N.E.2d 693, 700 (1989). AG/CUB conceded that ComEd is not seeking recovery of these expenses as a "surcharge" because its rates were too low in a prior period. Tr. at 585. There is, therefore, no basis upon which to find that inclusion of ComEd's rate case expenses in the test year amounts to retroactive ratemaking.

The expenses that AG/CUB and Staff propose to disallow are actual rate case expenses that, as of the time that the record closed in the 2005 rate case, were still estimates, and thus were incurred too late in the proceeding to be considered "actual costs" in that case.

This proposed disallowance would unlawfully deny ComEd the ability to recover reasonable and prudent costs. In ComEd's last case, some rate case expenses were still estimates at the time the record closed. ComEd was unable to recover the expenses there because the Commission was not certain what the final expenses would actually be. If, in the next case, once the expenses have actually been incurred, they are again excluded, this time on the grounds that ComEd is "too late," the result is to prevent these costs from ever being recovered, no matter how prudent and reasonable.

ComEd is not, contrary to the assertion of the AG, seeking to "relitigate" or "true up" its prior rate case expenses. ComEd is simply requesting that costs that the Commission neither approved nor denied in Docket 05-0597, and that have been shown to be prudent and reasonable test year costs, be recoverable in this case.

ComEd also includes in its revenue requirement its costs of rehearing in Docket 05-0597 incurred during the 2006 test year of $726,000 (representing $2.178 million of total costs amortized over three years). ComEd Ex. 7.0 Corr. at 41; ComEd Ex. 7.1, Sched. C-2.14. ComEd maintains that the amount at issue consists of prudently incurred reasonable expenses incurred during the test year. ComEd Ex. 25.0 Corr. at 63. Seeking recovery of rehearing costs in the course of the 2005 rate case would have been inappropriate. When ComEd proposed its rate case expenses, it could not have

known whether rehearing was going to be requested, by whom, or on what subjects. Nor could ComEd reasonably anticipate the specific issues the Commission would address or the expenses that would be associated with them. ComEd had no ability to provide any estimate of these expenses, if any. The costs of rehearing are now fully "substantiated" and should not be disallowed.

(b) AG

ComEd proposes recovery in the present case of three categories of expenses associated with its last rate case, Docket 05-0597: (1) the continuing amortization of the rate case expenses approved in that docket; (2) the recovery of amortized costs associated with the rehearing of that docket; and (3) the recovery of $2,986,000 in additional rate cases expenses from that docket. The Commission should reject recovery of these expenses.

The purpose of including normalized rate case expenses in a utility's recoverable operating expenses is to allow a reasonable opportunity to recover the cost of the rate case by including what is deemed to be a "normal" rate case expense in the cost of service. The problem that the AG has with ComEd's proposal is that the Company proposes to recover two sets of rate case expenses: costs from the 2005 case, and costs associated with the current rate case. The AG states that if a rate case expense in a given case is normalized over three years, but the subsequent rate case does not take place for another five years, that rate case expense from the first case will be over-recovered. In such circumstances, there is no practice the AG is aware of where the utility offers – or a regulatory commission requires – the utility to refund to ratepayers the over-recovered rate case expense. In this case, ComEd initiated a new rate case proceeding just two years after the prior one. The AG advocates that it is appropriate that the treatment of any "under-recovered" rate case expense should be symmetrical to the treatment of over-recovered rate case expense, and urges the Commission to reject recovery of prior rate case expenses once a new rate case is initiated.

The AG also advocates for the elimination of the amortization of the rehearing costs and the excess rate case costs related to Docket 05-0597. Allowing recovery of those costs prospectively from ratepayers is an exercise in retroactive ratemaking. ComEd makes baseless and conclusory assertions that the Commission would have found those expenses substantiated, but there is no way to know if that would be true. ComEd is seeking to relitigate an issue from the 05-0597 proceeding and demonstrate that its costs in that case were not fully recovered because the company can now provide better documentation of its expenses. The ICC is urged to eliminate these expenses from ComEd's operating expenses, resulting in a $4,212,000 reduction to the company's pro forma operation and maintenance expense.

(a) CUB

In this case, CUB states that ComEd includes rate case expenses in its pro forma operation and maintenance expenses. However, CUB argues the purpose of including the normalized rate case expense in the cost of service is not to guarantee a dollar-for-dollar recovery of the rate case expense incurred. AG/CUB Ex. 2.0 at 24. CUB recognizes that allowing recovery of those costs prospectively from ratepayers in

essence is retroactive ratemaking. CUB states that eliminating the amortization of the rate case expense from the revenue requirement is to reduce the Company's pro forma operation and maintenance expense by $4,212,000. AG/CUB Ex. 2.0 at 25, Schedule C-2.

(b) Staff

Staff's position on recovery of 2005 rate case expense incurred in the test year is that unlike the Company's proposal, its adjustment is reasonable and is consistent with the law. To reject Staff witness Griffin's adjustment would -- as he put it -- allow ComEd "to true up its prior rate case expense." Staff Ex. 2.0 Corr. at 18:347-348. A true up of rate case expense recovered through base rates would be contrary to the law. Specifically, it would constitute retroactive ratemaking. ComEd acknowledges that the Commission in its 2005 rate case only allowed it to recover $7,315,000 in rate case expense, but in this case ComEd now wants the Commission to allow it recovery of an additional $1,048,000 in 2005 rate case expense because that additional amount is now known and has been incurred. ComEd Ex. 25.0 Corr. at 62. In essence, ComEd's position is that the previously approved 2005 rate case expense was set too low by the Commission, and the Commission should now allow it to recover an additional amount equal to its incremental actual 2005 rate case expenses incurred in 2006. It is Staff's position that ComEd's position fails to consider prior case law. The Supreme Court held that "the Act does not permit retroactive ratemaking; that is, the law prohibits refunds when rates are too high and surcharges when rates are to low." *Citizens Utilities Co. v. Illinois Commerce Comm'n* (1988); *Business and Professional People I*, 136 Ill. 2d 192, 209 (1989). Clearly, to allow ComEd to recover incremental 2005 rate case expense actually incurred in 2006 would be a surcharge to the rates previously approved by the Commission for 2005 rate case expense.

Staff found ComEd's position to also be unfair. In Staff's opinion, ComEd's argument that these additional 2005 rate case amounts were incurred during the test year fails to consider that ComEd, in its prior rate case and its current rate case, chose to seek recovery of rate case expense based upon an amortized amount of rate case expense rather than actual rate case expense incurred in the test year. By seeking (1) the amortized 2005 rate case expense, (2) the amortized current rate case expense, and (3) the incremental additional rate case expense, ComEd wants it all. According to Staff, if ComEd wants recovery for the rate case expense actually incurred during the test year, *i.e.* 2006, then it cannot at the same time seek recovery of amortized rate case expenses which have not been incurred during the test year. That is, there should be no recovery of the unamortized 2005 rate case expense incurred prior to the test year and no recovery of the amortized rate case expense for the current docket, which were incurred subsequent to the test year. ComEd can't have it both ways. It must choose one or the other, but it can't have both.

Staff took no position on the 2005 rate case rehearing expenses in the 2006 test year.

(c) Commission Analysis and Conclusion

It is appropriate for the Company to recover the amortized 2005 rate expense as approved by the Commission in Docket 05-0597. We agree with Staff, however, that to now allow ComEd to recover more than the amount approved in Docket 05-0597 would be inappropriate. The Company should not recover both the amortized amount allowed by the Commission and an additional amount the Commission has not approved. This would essentially be an inappropriate true-up.

With respect to the rehearing expenses that the Company actually incurred in the test year, no party argues that the amount claimed by ComEd is unreasonable. It is merely that the short time frame between rate cases results in these expenses from the last rate case occurring in the chosen test year for this case. No party disputed the use of the 2006 test year and these costs were actually incurred by the Company. Accordingly, they are approved.

5. New Business Revenue Credit

a) ComEd

Consistent with the Commission's Order in ComEd's 2005 rate case, ComEd, in calculating its revenue requirement, proposed a revenue credit of $26.401 million to reflect the anticipated increase in new business revenue associated with the pro forma capital additions. ComEd Ex. 7.0 Corr. at 37; ComEd Ex. 7.1, Sched. C-2.16; ComEd Ex. 7.2, Work Paper WPC-2.16.

Under the Staff/ComEd joint recommendations, ComEd's pro forma capital additions for the third quarter of 2008 are to be excluded from rate base, in which case the credit should be reduced by $3.758 million.

In response to AG/CUB's proposal to increase the new business revenue credit by a further $4.776 million, ComEd argues that when it calculated the credit, it estimated kilowatt hour sales growth for new residential, small commercial and industrial ("SCI"), and large commercial and industrial ("LCI") customers associated with the pro forma new plant additions for 2007 and the first three quarters of 2008. The estimate relied on 2006 actual customer growth statistics, which led to a calculated credit of $26.401 million. ComEd Ex. 7.2, Work Paper WPC-2.16. The Commission accepted, and AG/CUB supported, this method, e.g., use of test year data to project growth into the period of the pro forma additions, in Docket 05-0597. Tr. at 606-607. This is true even though actual data (at least for 2005) was available at the time of the Commission's July 2006 Order in that docket.

During discovery, AG/CUB asked ComEd to provide the actual customer growth in 2007. ComEd provided the requested information, with caveats (described below), which Mr. Effron then used to calculate his adjustment for new customer growth for 2007 and the first three quarters of 2008 of $31.177 million, or $4.776 million more than ComEd had calculated. AG/CUB Ex. 5.0 at 5. ComEd believes that AG/CUB has misinterpreted the information provided.

The data request response upon which AG/CUB bases its calculation specifically indicated that the number of new large commercial and industrial customers shown for 2007 was inappropriate to use in estimating kWh sales associated with the new plant additions because that number had no relation to any new plant additions. Specifically, in 2007 there was a significant migration of customers from small commercial and industrial to large commercial and industrial accounts. These customers simply moved from one customer class to another and are not "new" customers. They are, therefore, unrelated to the pro forma plant additions.

As explained in ComEd's surrebuttal testimony, ComEd conducted an analysis to evaluate the portion of total growth in the large customer class actually resulting from new customers. ComEd compared the list of large customers as of 2007 with the list as of 2006, and removed those customers who existed but were not classified as "large" in 2006. This analysis resulted in a true increase of 16 new large customers in 2007. ComEd's initial estimate, upon which it based its calculation of the credit, was 17 new large customers. ComEd Ex. 40.0 Corr. at 31.

Despite this, AG/CUB witness Effron elected to use the atypical 2007 customer growth data to estimate the revenues associated with the pro forma plant additions in his rebuttal testimony. ComEd then presented further analysis of the 2007 customer statistics to specifically remove the growth that resulted from the migration of customers from the small commercial and industrial class to the large commercial and industrial class. This analysis demonstrated that AG/CUB's adjustment, which included the effect of customers simply moving into the large customer class, overstated the increase in kilowatt-hours sales attributable to truly new large commercial and industrial customers by more than 200%. ComEd Ex. 40.0 Corr. at 30-31. According to ComEd, the evidence shows that AG/CUB's calculation of the new business revenue credit does not reflect growth that actually happened, and thus its proposed $4.776 million upward adjustment to the ComEd revenue credit of $26.401 million overstates the expected revenues that the pro forma plant additions will generate. The Company argues that AG/CUB's proposal should be rejected.

b) AG

The AG asserts that it is necessary to adjust the new business revenue credit. On ComEd Workpaper WPC-2.16, the revenue credit related to new business plant additions is based on general customer growth rates but does not incorporate the addition of new customers related to specific plant additions. Since the AG proposes that the level of plant additions be based on the actual levels of plant additions in 2007, the calculation of the revenue credit related to new business plant additions must be modified so that it is consistent with actual plant additions in 2007. ComEd recalculated the new business revenue credit based on actual customer growth in 2007, and the projected customer growth over the first nine months of 2008 is $31,177,000. AG/CUB Ex. 5.2. This is $4,776,000 greater than the new business revenue credit reflected by ComEd in its calculation of pro forma operating income under present rates. Therefore, the AG claims the new business revenue credit should be increased by $4,776,000.

ComEd states that AG/CUB witness Effron overstates the potential growth when he relies upon 2007 data – a year the company argues is not typical. ComEd Ex. 40.0

at 31-32. Regardless of whether the growth in 2007 is or is not typical, it represents what actually happened and is therefore consistent with the inclusion of actual 2007 plant additions in rate base. ComEd agrees that in both the current rate case, and the previous case, Docket 05-0597, the proposed rates sought by the Company were used to estimate the total amount of new business revenue the Company could expect. Tr. at 101. This mirrors what Mr. Effron proposes to do in the current case: adjust the Company's total revenue requirement for the anticipated increase in revenue, generated by new customers using the Company's own proposed rates, just as the Company did in its last rate case.

The adjustment to reflect customer growth is an adjustment to operating revenues on ComEd Schedule C-2, not an adjustment to "Other Revenues"; thus, the method of incorporating the new business revenue credit should be modified. To accurately reflect the impact of this adjustment, it should be shown as an increase to operating revenues – which in turn results in an increase to the total revenue requirement but not the calculated revenue deficiency.

c) Commission Analysis and Conclusion

The Company has shown that the growth in customers the AG relies on for its adjustment was in reality based on customers migrating from one class to another. Moreover, the Company's calculation is consistent with the Commission's decision in Docket 05-0597. Accordingly, the AG's adjustment is not warranted.

6. Depreciation and Amortization Expenses (Derivative and Direct Adjustments)

Staff proposes a direct adjustment to depreciation expense related to the depreciable life of the Post-2006 Project, as discussed in Section IV.C.1.e. The remainder of Staff's and Intervenors' proposed adjustments to depreciation expense are entirely derivative of their various uncontested and contested proposed adjustments to plant and are only approved to the extent that the proposed adjustments are approved.

7. Taxes Other than Income Taxes (Derivative Adjustments)

Staff and Intervenors have proposed no direct adjustments to taxes other than income taxes ("TOTI"). Their proposed adjustments to TOTI are entirely derivative of their proposed adjustments and, accordingly, are approved only to the extent that the proposed adjustments from which they are derived are approved.

8. Income Taxes (Derivative Adjustments)

Staff and Intervenors proposed no direct adjustment to income taxes.

D. Operating Expenses (Total)

Based on the electric utility delivery services operating expense statement as originally proposed by ComEd and the adjustments to operating revenues and expenses as summarized above, the total electric utility delivery services operating expenses for ComEd approved for purposes of this proceeding are $1,530,445,000. The operating expense statement may be summarized as follows:

Approved Operating Expense Statement
(In Thousands)

Operating Revenues	$ 1,961,065
Other Revenues	129,003
Total Operating Revenue	2,090,068
Uncollectibles Expense	14,407
Distribution	310,586
Customer Accounts	133,158
Customer Services and Informational Services	8,462
Sales	0
Administrative and General	330,554
Depreciation and Amortization	345,339
Taxes Other Than Income	155,780
Regulatory Debits	34,415
Total Operating Expense Before Income Taxes	1,332,701
State Income Tax	25,478
Federal Income Tax	117,763
Deferred Taxes and ITCs Net	54,503
Total Operating Expenses	1,530,445
NET OPERATING INCOME	$ 559,623

The development of the overall electric utility delivery services operating expense statement adopted for purposes of this proceeding is shown in the Appendix to this Order.

VI. Rate of Return

A. Capital Structure (Uncontested)

Staff recommended a December 31, 2006, capital structure consisting of 54.96% long-term debt and 45.04% common equity. Staff Ex. 4.0 Corr. at 3. ComEd and CUB did not object to Staff's proposed capital structure, and IIEC did not address Staff's proposal in its testimony. ComEd Ex. 28.0 at 10; CUB Ex. 4.0 at 14.

ComEd's capital structure is not at issue in this proceeding. There being no evidence to the contrary, the Commission accepts the capital structure presented by the Company. We therefore find that ComEd's capital structure should consist of 54.96% long-term debt and 45.04% common equity.

B. Cost of Long-Term Debt (Uncontested)

Staff and ComEd agree that the proper estimate for cost of long-term debt is 6.78%. ComEd Ex. at 12; Staff Ex. 17.0 at 2.

The Commission concludes that ComEd's cost of long-term debt for purposes of this Order is 6.78%.

C. Cost of Common Equity

1. ComEd

ComEd witness Hadaway performed an extensive analysis demonstrating that the investor-required cost of equity capital for ComEd is 10.75%. ComEd Ex. 10.0 at 1. Dr. Hadaway's conclusion is supported by a discounted cash flow ("DCF") study using growth rates from four recognized securities analysts, as well as by capital asset pricing model ("CAPM") analyses. *Id.* at 37. In arriving at his cost of equity estimate, Dr. Hadaway notes ComEd's weakened financial condition and depressed credit ratings, and the close attention that rating agencies will pay to the rate relief provided by the Commission in this proceeding. *Id.* at 6-7.

ComEd stated that the principal objection raised by Staff and IIEC to Dr. Hadaway's 10.75% cost of equity result is their contention that Dr. Hadaway used a GDP growth rate in his DCF analysis that they believe is unsustainably high. ComEd explained that, while Dr. Hadaway did present a DCF analysis using the GDP growth rate, he recognized that the Commission favored use of analysts' estimates and therefore performed a stand-alone DCF analysis using only analysts' growth rates. The analysts' growth rates of the companies in Dr. Hadaway's comparable group were actually 20% lower than the growth rates for Staff's sample group (6.05% versus 7.72%), further indicating the conservatism of Dr. Hadaway's approach. Staff Ex. 4.0 Schedule 4.5; ComEd Ex. 10.5. ComEd concludes that the updated quarterly dividend DCF analysis performed by Dr. Hadaway resulted in a reasonable cost of equity range of between 10.3 and 11.1 percent. ComEd Ex. 29.0 at 25; ComEd Ex. 29.7. The midpoint of this reasonable range is 10.7%.

ComEd observes that the Commission traditionally relies on both a DCF and a CAPM analysis when determining a utility's cost of equity. Staff's CAPM analysis concludes that ComEd's cost of equity is 11.25%. Staff Ex. 4.0 at 27; Schedule 4.9. ComEd adds that the average of Dr. Hadaway's DCF analysis using only analysts' growth rates and Staff's CAPM analysis results in a cost of equity for ComEd of 10.98% (10.7% + 11.25% / 2). Thus, ComEd states that this outcome demonstrates the reasonableness of Dr. Hadaway's 10.75% cost of equity conclusion.

The analyses performed by IIEC witness Gorman also supports the approval of a 10.75% cost of equity for ComEd. IIEC's CAPM study produced a 10.7% cost of equity, while its traditional DCF analysis outcome was 11%. The average of these two results produces a 10.85% cost of equity. IIEC Exs. 2.17 and 2.6.

ComEd states that rising interest rates support the conclusion that ComEd's cost of equity is increasing, making a 10.75% cost of equity appropriate and reasonable. ComEd noted that interest rates for triple-B corporate borrowers, like ComEd, increased

from 6.36% in September 2007 when this proceeding was filed to 6.68% by March 2008. Corporate interest rate spreads (corporate interest rates minus U.S. Treasury rates) also increased, reflecting the ongoing market turbulence that corporate entities face in their efforts to raise capital. ComEd Ex. 42.0 at 2. Given these increases, the suggestion from CUB witness Thomas that ComEd's cost of equity is only 7.77%, barely above the average cost of triple-B debt, is unsupportable, as both Dr. Hadaway and Staff witness McNally demonstrated. ComEd Ex. 29.0 at 21; Staff Ex. 17.0 at 8-18. ComEd observes that even Mr. Thomas acknowledged that the return on equity and weighted average cost of capital resulting from his recommendations are lower than any electric distribution returns the Commission has authorized in the last 35 years. Tr. at 1839.

In addition to its unreasonable outcome, ComEd explains that CUB's analysis is deficient and cannot be relied upon to determine ComEd's cost of equity. CUB'S analysis is based on methodologies and assumptions the Commission has considered and repeatedly rejected. ComEd notes that CUB's annual version of the constant growth DCF model was rejected in North Shore and Peoples Gas, Dockets 07-0241/07-0242 (Cons.), Order at 99. ComEd Ex. 29.0 at 21. CUB's growth rate for its DCF analysis is based entirely on the "b times r" sustainable growth rate approach, which the Commission rejected in GTE North, Dockets 93-0301, 94-0041. ComEd Ex. 29.0 at 21. ComEd adds that CUB's recommendation to discontinue use of the CAPM approach was rejected by the Commission in its February 5, 2008, Final Order in the Peoples proceeding. Dockets 07-0241/07-0242 (Cons.), Order at 97. Thus, ComEd concludes that there is no basis in the record for approval of CUB's thoroughly discredited 7.77% cost of equity result.

Another factor supports the approval of a 10.75% cost of equity for ComEd. On March 14, 2008, ComEd states that the Staff recommended a return on equity of 10.68% for the Ameren electric utilities in Dockets 07-0585 – 07-0590. It notes that Mr. McNally included Ameren as one of nine utilities "most comparable to" ComEd. Staff Ex. 4.0 Corr. at 9. Also, ComEd states that IIEC also includes Ameren in its sample of utilities comparable to ComEd. IIEC Ex. 2.6. Dr. Hadaway reaches the same conclusion that ComEd and Ameren are comparable companies. ComEd Ex. 10.1. In addition, Dr. Hadaway confirms that there is no basis for approving a higher cost of equity for the Ameren utilities than for ComEd. Staff Ex. 4.0 Corr. at 6.

The only difference between the 10.68% cost of equity Staff recommends for Ameren and the 10.3% cost of equity it recommends for ComEd is that the 10.68% result is based on more recent data. Unfortunately, ComEd notes that Staff did not update its analysis of ComEd's cost of equity in this proceeding to reflect the more recent information and therefore introduced an unsupportable inconsistency between Staff's positions in the ComEd and Ameren proceedings.

Dr. Hadaway performed an update of Staff's analysis of ComEd's cost of equity to take into account data inputs as of the dates of Staff's Ameren analysis. Dr. Hadaway made no other adjustments to Staff's analysis because Staff's estimation methodology in the Ameren and ComEd cases is the same. ComEd Ex. 42.2. ComEd observed that the update of Staff's ComEd cost of equity estimate with data as of the

same dates used in the Ameren proceeding resulted in a 10.65% cost of equity for ComEd. ComEd Ex. 42.0 at 5. This result is nearly identical to Dr. Hadaway's estimate of ComEd's cost of equity. Dr. Hadaway also updated IIEC's cost of equity estimate, concluding that it resulted in a cost of equity for ComEd that is "very similar, if not higher, than [Dr. Hadaway's] ROE recommendation of 10.75 percent." ComEd Ex. 29.0 at 15.

ComEd recommends that the Commission approve a cost of equity using updated information. Given the similar outcomes from Staff's, IIEC's and ComEd's approaches when updated inputs are applied, adopting the 10.75% return on equity supported by Dr. Hadaway's analysis is the appropriate course of action. ComEd states that it is consistent with the record, will contribute greatly to the restoration of ComEd's financial health, and will demonstrate the Commission's commitment to that objective. However, if the Commission does not approve the 10.75% return on equity supported by Dr. Hadaway's analysis, ComEd states that it should approve the 10.65% return resulting from the update of Staff's cost of equity study.

2. Staff

Staff witness McNally estimated ComEd's investor-required rate of return on common equity to be 10.30%. Staff Ex. 4.0 Corr. at 28. Mr. McNally measured the investor-required rate of return on common equity using discounted cash flow ("DCF") and CAPM analyses. Mr. McNally applied those models to a sample of electric utility and gas distribution utility companies ("Comparable Sample") chosen on the basis of a principal components analysis using six financial and operating ratios over the 2004-2006 period. After calculating the scores for each principal component, he rank-ordered the companies in terms of least relative distance from ComEd's target scores. The Comparable Sample consisted of the nine utilities the least distance from, and therefore, the most comparable to, ComEd that: (1) were assigned an S&P issuer credit rating in the A or BBB rating categories; (2) had growth rates from Zacks Investment Research, Inc. ("Zacks"); (3) paid consistent quarterly dividends; (4) had sufficient price data to calculate beta; and (5) had no pending nor recently completed significant mergers, acquisitions, or divestitures. Staff Ex. 4.0 Corr. at 8-9.

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. The companies in Mr. McNally's Comparable Sample pay dividends quarterly. Therefore, Mr. McNally applies a quarterly DCF model. Staff Ex. 4.0 Corr. at 12.

Mr. McNally employed a multi-stage, non-constant DCF model in his DCF analysis. Mr. McNally explained that Staff does not typically use a non-constant growth DCF model because it is a more elaborate model with additional unobservable growth rate variables that are likely subject to greater measurement error than the analyst growth rate estimates Staff uses in constant-growth DCF analyses. However, the cost of common equity estimate derived from a constant-growth DCF model is appropriate to use only if the near-term growth rate forecast for each company in the sample is expected to equal its average long-term dividend growth. In this case, the expected

near-term growth level for the Comparable Sample (7.72%) was over 50% greater than that expected for the overall economy, as measured by GDP growth (approximately 5%). Mr. McNally explained that, in theory, no company could sustain into infinity a growth rate any greater than that of the overall economy, or it would eventually grow to become the entire economy since the rest of the economy would become infinitesimal in relation. Moreover, since utilities in particular are generally below-average growth companies, the sustainability of an above average growth rate is particularly dubious. Thus, given the large difference between the growth rates for the Comparable Sample companies and the overall growth of the economy, the continuous sustainability of the Zacks growth rates for the Comparable Sample is highly unlikely. Therefore, Mr. McNally concluded that the measurement error associated with a constant-growth DCF analysis exceeds that associated with a non-constant growth DCF model, making the latter model preferable. Staff Ex. 4.0 Corr. at 12-13.

Mr. McNally's non-constant growth DCF model incorporated three stages of dividend growth. The first, a near-term growth stage, is assumed to last five years. For this stage, Mr. McNally used Zacks growth rate estimates as of February 1, 2008. The second stage is a transitional growth period that spans from the beginning of the sixth year through the end of the tenth year. The growth rate employed in the transitional growth period equals the average of the Zacks growth rate and the "steady-state" stage growth rate. Finally, the third, or "steady-state," growth stage commences at the end of the tenth year and is assumed to last into perpetuity. For this stage, Mr. McNally utilized the implied 20-year forward U.S. Treasury rate in ten years, which reflects current expectations of the long-term overall economic growth during the steady-state growth stage of his non-constant DCF model. An implied 20-year forward U.S. Treasury rate in ten years of 4.73% was derived from the 10- and 30-year U.S. Treasury bond rates as of February 1, 2008.

An expected stream of dividends for each company in the Comparable Sample was then estimated by applying the growth rate estimates for those three stages to the February 1, 2008, dividend. The discount rate that equates the present value of this expected stream of cash flows to the company's February 1, 2008, stock price equals the market-required return on common equity. Based on this growth, stock price, and dividend data, Mr. McNally's DCF estimate of the cost of common equity was 9.35% for the Comparable Sample. Staff Ex. 4.0 Corr. at 14, 17.

According to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with the theory that investors are risk-averse and that, in equilibrium, two securities with equal quantities of risk have equal required rates of return. Mr. McNally uses a one-factor risk premium model, the CAPM, to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification. Staff Ex. 4.0 Corr. at 18-19.

The CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. For the beta parameter, Mr. McNally combined adjusted betas from Value Line and a regression analysis. The average Value Line beta estimate was 0.82, while the regression beta estimate was 0.67. Staff

Ex. 4.0 Corr. at 24-27. For the risk-free rate parameter, Mr. McNally considered the 1.74% yield on four-week U.S. Treasury bills and the 4.37% yield on thirty-year U.S. Treasury bonds. Both estimates were measured as of February 1, 2008. Forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 4.4% and 5.6%. Thus, Mr. McNally concluded that the U.S. Treasury bond yield is currently the superior proxy for the long-term risk-free rate. Staff Ex. 4.0 Corr. at 19-23. Finally, for the expected rate of return on the market parameter, Mr. McNally conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis estimated that the expected rate of return on the market equals 13.55%. Staff Ex. 4.0 Corr. at 24. Inputting those three parameters into the CAPM, Mr. McNally calculated a cost of common equity estimate of 11.25% for the Comparable Sample. Staff Ex. 4.0 Corr. at 27.

Based on his DCF and risk premium models, Mr. McNally estimated that the cost of common equity for the Comparable Sample is 10.30%. To determine the suitability of that cost of equity estimate for ComEd, Mr. McNally assessed the risk level of his Comparable Sample relative to that of ComEd. The companies composing the Comparable Sample were selected based on the similarity of their financial and operating ratios to those of ComEd, which indicates a very similar degree of overall risk. Thus, Mr. McNally concluded that the Comparable Sample appropriately reflects the risk level of ComEd and no risk adjustment is necessary. Staff Ex. 4.0 Corr. at 10-11, 27-29.

Staff witness McNally found ComEd witness Hadaway inappropriately used unsustainably high growth rates in his DCF analyses, which lead to an overstated cost of equity estimate. Staff Ex. 4.0 Corr. at 30. Staff witness McNally testified that the near-term, company-specific growth rates for Dr. Hadaway's Utility Sample, like those for Mr. McNally's Comparable Sample, are not sustainable over the long term, based on current expectations of long-term economic growth. Forecasts from EIA, Global Insight, and the Survey, as well as current U.S. Treasury bond yields, including Dr. Hadaway's own risk-free rate estimate, all indicate expectations of long-term growth in the overall economy of approximately 5%. Staff Ex. 4.0 Corr. at 30; ComEd Ex. 10.7. In contrast, the average near-term growth rate for Dr. Hadaway's Utility Sample is approximately 20% greater, at 6.05%. Since utilities are generally below average growth companies, it is unlikely investors expect the companies in Dr. Hadaway's sample to be able to sustain above average growth. Staff Ex. 4.0 Corr. at 30-31.

It is Staff's position that, under such circumstances, it would be appropriate to employ a non-constant DCF model, which Dr. Hadaway did. Unfortunately, rather than address the unsustainable growth rate error, Dr. Hadaway compounded it by employing an even higher, historically-based GDP estimate of 6.50% for the steady-state stage of his non-constant DCF analysis. Moreover, in one of his constant-growth DCF analyses, he abandoned his near-term, company-specific growth rate estimates altogether, using the higher GDP growth estimate exclusively, further exacerbating the unsustainable growth rate error. Staff Ex. 4.0 Corr. at 31.

In Staff's opinion the Company has not demonstrated that Dr. Hadaway's GDP growth rate estimate reflects investors' current expectations of future overall economic growth, much less that of the companies in his sample. In fact, Dr. Hadaway's GDP

growth rate does not measure current investor expectations of future economic growth, but rather, equals the average achieved growth rate over various historical periods from 1947-2007. ComEd Ex. 29.05. The Company provides no evidence to demonstrate that investors set their long-term expectations of future growth on growth achieved over that past 60 years, much less, in the specific manner Dr. Hadaway did. Furthermore, the actual, published GDP forecasts noted above indicate that expectations for future GDP growth are much lower than the GDP growth rate Dr. Hadaway employed. Moreover, while the risk-free rate and the GDP growth rate should be similar, as both are functions of production opportunities and consumption preferences without the effects of a risk premium, Dr. Hadaway's 6.5% GDP growth estimate is much closer to riskier BBB-rated utility debt rates than the risk-free rate, which, Dr. Hadaway himself estimated to be 5.08%. Staff Ex. 4.0 Corr. at 23; ComEd Ex. 29.0 at 5. Thus, the Company's assumption that investors expect 6.50% long-term growth for GDP, let alone for utilities, is highly dubious. Staff Ex. 4.0 Corr. at 31.

Staff also points out that the Value Line forecasts of the earnings retention rates for the companies in Dr. Hadaway's sample provide further evidence that the 6.60% GDP growth rate is not a reasonable estimate of the sustainable growth for the companies in Dr. Hadaway's Utility Sample. The 33.5% average Value Line retention rate forecast for the companies in Dr. Hadaway's Utility Sample, combined with Dr. Hadaway's 10.75% return on equity estimate, indicate a sustainable growth of only 3.60% (33.5% × 10.75% = 3.60%). In contrast, in order to sustain 6.50% growth, either the return on equity for the companies in his Utility Sample would have to average approximately twice the 10.75% cost of equity Dr. Hadaway estimated, or the average retention rate for those companies would have to be nearly twice the 33.5% average Value Line forecast. Staff Ex. 4.0 Corr. at. 32. While one can debate whether investors' true expectation for the average retention rate is, for example, 30% or 40%, the retention rate of greater than 60% that Dr. Hadaway's 6.5% growth rate implies is completely out of line with the forecast from a source that Dr. Hadaway refers to as "reputable." ComEd Ex. 10.0 at 3. Similarly, while one can debate whether the rate of return on new investment for a particular utility should be, for example, 10% or 11%, the 21.62% rate of return on new investment Dr. Hadaway's 6.5% growth rate implies is clearly beyond any range of reasonableness. Thus, while the sustainable growth for Dr. Hadaway's Utility Sample may not be precisely 3.6%, it is almost certainly not 6.5%.

Staff also asserts Dr. Hadaway's risk premium analysis contains several flaws that undermine the reliability of the resulting estimates. Dr. Hadaway's testimony failed to specify many critical factors that influenced the allowed returns that form the basis of that analysis, including the relative risk of the utilities involved in those return decisions, the capital structure that was adopted, or the amount of the common stock flotation cost adjustment, if any, that was included in each of those decisions. Without such data, any evaluation of the return recommendations in this proceeding via comparison to the authorized returns reflected in the data Dr. Hadaway cites is useless, since we have no basis on which to assess comparability. Staff Ex. 4.0 Corr. at 32-33.

In addition, his risk premium analysis is based on a regression of average equity risk premium relative to the concurrent average utility bond yield during the 1980

through 2006 period, which presents two problems. First, in a regression, the predictive ability of the historical sample regression line falls markedly as the observation departs progressively from the mean. The 6.70% projected single-A utility bond yield estimate Dr. Hadaway employed is significantly below the 9.35% average of the observations in the study. Thus, it is questionable whether the relationship he modeled holds at such a relatively low interest rate. Second, Dr. Hadaway has provided no evidence to demonstrate that the linear regression equation he developed for the 1980-2006 period is stable over a greater length of time. That is, he has not shown that the relationship he modeled between interest rates and equity risk premia applies to the projected utility bond yield he employed. Staff Ex. 4.0 Corr. at 33-34.

Finally, in Docket 05-0597, Dr. Hadaway acknowledged that his risk premium analysis, which is the same as that which he uses in this proceeding, suffers from "statistical deficiencies." In that proceeding, Dr. Hadaway used his risk premium results merely as a "check of reasonableness" of his DCF results. In contrast, Dr. Hadaway gave "explicit weight" to his risk premium analysis in the instant docket.

It is also Staff's position that Dr. Hadaway arbitrarily weights the results of his various individual cost of equity models, leading to an ultimate cost of equity recommendation that is inconsistent with those results. Specifically, his recommended DCF range of 10.5% to 11.1% reflects only the high-end of the ranges for his various DCF analyses. If he had reflected the full range of the DCF outcomes he presents, his DCF range would be 9.6% to 11.1%. The midpoint of that range suggests a cost of equity of 10.35%. Staff Ex. 4.0 Corr. at 34.

Staff takes issue with CUB employing an annual DCF model, rather than a quarterly model, as Staff employed. CUB Ex. 1.0 at 23. Staff explains that incorporating stock prices that the financial market sets on the basis of quarterly dividend payments into a model that ignores the time value of quarterly cash flows constitutes a misapplication of DCF analysis. Staff Ex. 4.0 Corr. at 11-12. Staff also explains that the argument regarding the use of a quarterly DCF versus an annual DCF model is a basic question of the time value of money. Staff points out that while CUB witness Thomas acknowledges the greater value to investors of quarterly dividends relative to a single, annual dividend of the same total amount paid at the end of the year, he fails to acknowledge that greater value to investors means a greater cost to the Company, since the investors' required return is the Company's cost of equity. Therefore, Mr. Thomas' approach does not compensate the Company for that additional cost. In contrast, the quarterly DCF properly compensates Company for the cost it incurs.

Staff also takes issue with Mr. Thomas' DCF analysis, because he relied solely on a "b x r" growth rate estimate of 3.09% derived from historical data, rather than relying on analysts' forecasted growth rates, as Staff and the Company did. Staff cites a study that indicates that analyst growth rate estimates for utilities, in particular, are not overstated relative to their achieved growth. Thus, reliance on analysts' growth rates for utilities does not appear to produce an upwardly biased cost of equity. Staff also takes issue with Mr. Thomas' argument that incorrectly implies that analyst growth rates should be judged on their ability to accurately predict future growth, rather than on their value as proxies for investors' ex ante expectations. According to Staff, the significant

question is whether or not analyst growth rates accurately portray investor expectations of future growth. It is Staff's position that Mr. Thomas has presented no evidence to demonstrate that analyst growth rates are poor proxies for investor growth expectations. Staff Ex. 17.0 at 8-10.

In response to Mr. Thomas' argument that in circumstances where the dividend payout ratio is expected to change, a "b x r" growth rate estimate is superior to analysts' forecast, Staff explains there are several problems with rejecting analysts' growth forecasts based solely on the divergence of Value Line's DPS and EPS projections. Moreover, even if one were to agree that the divergence of DPS and EPS growth disqualifies either for use in a DCF analysis, a growth rate that is almost a full percentage point less than either the EPS or DPS growth projection is an inappropriate alternative. The "b x r" growth rate formula reveals that when DPS grows more slowly than EPS, sustainable growth must, by the laws of mathematics, be higher than DPS growth, not lower. Thus, according to Staff, even if one accepts Mr. Thomas' argument that the difference in the Value Line growth projections for DPS and EPS is sufficient for rejecting them both, the long-term steady state growth rate must be higher than the 4.03% DPS growth rate and, consequently, the 3.09% growth rate Mr. Thomas employed is clearly understated. Staff Ex. 17.0 at 11-13.

Staff also points out that Mr. Thomas inconsistently applied a growth rate that reflects historical dividend payout ratios with dividend yields that reflects current dividend payout ratios. In support Staff points out the following. First, growth rates derived from historical data are inconsistent with the prospective nature of the cost of common equity. While a historical perspective has value in forecasting the future, one cannot reasonably forecast the future by looking exclusively to the past, as Mr. Thomas did. In fact, the same historical data Mr. Thomas used is also available to security analysts who have the added benefit of current information that can be incorporated to improve their forecasts of future growth relative to forecasts based on historical data alone. Second, as Mr. Thomas notes, Value Line earnings per share and dividend per share growth data indicate that the average dividend payout ratio for his sample is expected to fall which, conversely, indicates that the average retention ratio for his sample is expected to rise. The lower retention ratios during the historical period from which Mr. Thomas derived his "b x r" growth rate (*i.e.*, 2002-2006) produced lower growth rates than would be expected going forward, all else equal. Conversely, the higher retention ratios going forward would produce a lower dividend yield than experienced in the past, all else equal. Thus, Mr. Thomas mismatched the growth rates from 2002-2006 (when retention rates were lower and, thus, dividend yields were higher) with the current dividend yields (when retention rates are higher and, thus, dividend yields lower). This inconsistency between the retention rate and dividend yield measurement periods contributes to Mr. Thomas' underestimation of the cost of equity. Staff Ex. 17.0 at 13-14.

The above notwithstanding, Mr. Thomas presented no reason to reject analysts' growth rates altogether. Indeed, Mr. Thomas' argument was not that analyst growth rates should be disregarded entirely if they are upwardly biased, but that they should not be the used exclusively in that case. In fact, he repeated that sentiment at least

three times in his testimony. Nevertheless, despite presenting analyst EPS growth rates from four separate sources, Mr. Thomas ignored them when performing his DCF analysis. Instead, Mr. Thomas elected to rely solely on a "b x r" growth rate estimate derived from historical data. That approach produced a growth rate of 3.09%, which is almost one full percentage point lower than the lowest of the four analyst EPS growth rates noted in his testimony and over three percentage points lower than the Reuters analyst growth rate he presented. Obviously, if, as his argument suggests, Mr. Thomas were to have given any weight to any of those analyst growth rates in his DCF analysis, the resulting cost of equity would have been higher than his 7.77% recommendation. Staff Ex. 17.0 at 10-11. Moreover, numerous studies have shown that analyst growth rate estimates are better predictors of actual growth rates than are predictors based solely on historical information and that the results of valuation models, such as the dividend growth model, are typically more accurate when the growth rate comes from analyst forecasts. Staff Ex. 17.0 at 13.

Staff takes issue with Mr. Thomas' challenge to the direct application of the CAPM in determining ComEd's cost of equity, claiming that a paper by Gregory L. Nagel *et al*. (the "Nagel paper") "rejects the version of the CAPM traditionally used by the Commission." Staff explains that the Nagel paper did not evaluate and, thus, did not reject the version of the CAPM traditionally used by the Commission. Specifically, the Nagel paper does not apply to Staff's CAPM, because it does not evaluate a CAPM that utilizes adjusted betas. Rather, the Nagel Paper found that a CAPM using raw betas was less accurate in predicting realized rates of return than a naïve model that assumes the same cost of equity, equal to the risk-free rate plus a risk premium, applies to all stocks (*i.e.*, all betas equal 1.0). Ironically, after asserting that the CAPM can only be used if the Commission "carefully selects the appropriate beta," Mr. Thomas recommended the use of raw betas in the CAPM analysis he presented as a check of his DCF analysis, despite his own sources' explicit rejection of such an approach. Staff Ex. 17.0 at 15.

Staff also takes issue with Mr. Thomas' criticism regarding the use in the CAPM of betas adjusted for reversion to the market mean of 1.0, citing a study that concluded that utility betas actually revert to a utility average beta rather than the market mean. Staff finds Mr. Thomas' criticism to be unfounded. The beta parameter used in CAPM analyses is generally derived from historical data, but, in theory, should be a forward-looking number. Ex post empirical tests of the CAPM suggest that the linear relationship between risk, as measured by raw (*i.e.*, historical) beta, and return is flatter than the CAPM predicts. That is, securities with raw betas less than one tend to realize higher returns than the CAPM predicts, while securities with raw betas greater than one tend to realize lower returns than the CAPM predicts. Thus, Staff adjusted the raw betas to improve the accuracy of its beta estimates. Doing so produces predicted rates of return are more similar to observed realized rates of return. Thus, adjusted betas surpass raw betas as predictors of future returns and are, therefore, superior forward-looking betas. Studies have shown that such adjustments result in appreciably better forecasts, finding that the reduction in both bias and inefficiency is greater the farther away the beta is from one. Even if one accepts that utility betas actually revert to a utility average beta rather than the market mean of 1.0, the derivation of the true

industry mean beta is problematic. Not only is any estimate of the true industry portfolio beta mean dubious, as betas change over time, but the farther below the market mean a raw beta is, the more likely its estimate error is to be negative. Thus, the average of a portfolio of low betas, each of which is likely to be biased downward, will, itself, likely be biased downward. Regardless, as noted previously, Mr. Thomas's proposal to ignore beta reversion altogether and use an unadjusted beta was explicitly rejected in the Nagel paper he cited. Staff Ex. 17.0 at 16-17.

In response to Mr. Thomas' suggestion that the proper expected common equity market risk premium for determining the investor-required rate of return is between 3% and 5%, Staff notes that the research cited by Mr. Thomas represents various academics' opinions of the common equity risk premium investors should expect, which is not necessarily the same as what the investors truly are expecting. According to Staff, since the relationship between the returns of the stock market and U.S. Treasury bonds is not stable over time, current returns provide the best indication of what investors are expecting going forward. Hence, it is Staff's position that its estimate of the common equity risk premium, derived by subtracting the current yield on long-term U.S. Treasury bonds from the required return on the S&P 500 provides the actual difference between returns on risk-free and risky securities that exists in today's market. Staff Ex. 17.0 at 17-18.

Staff also responds that with respect to ComEd's "update" of Staff's proposal, it, too, is flawed, as the Company chose to update only selected portions of Staff's analysis. Specifically, Company witness Hadaway failed to update the Zacks growth rates for Staff's DCF analyses or the betas employed in Staff's CAPM analysis. ComEd Ex. 42.2. Those key inputs are the two most contentious factors in those models. If an update were necessary, and it is not, it is unreasonable to update certain inputs, but fail to update all inputs, particularly two of the most critical inputs. Indeed, the very reason the Company proposes an update, is because inputs (such as growth rates and betas) change. Thus, the Company cannot accurately claim that its "update" reflects what Staff's cost of equity estimate would have been if performed on February 14, 2008. In fact, that "updated" estimate is of no value in determining ComEd's cost of equity, as it does not represent the cost of equity at any single time.

Moreover, Staff does not endorse the allowance of updates in later rounds of testimony, unless good cause is shown (*i.e.*, not simply for the sake of increasing the revenue requirement, such as ComEd is proposing). From a policy perspective, the allowance of optional updating from case to case would encourage utilities to selectively update only in proceedings in which, or only those factors for which, such updates would increase the cost of capital. The end result would be upward updating but no downward updating to cost of equity estimates by utilities. More generally, Staff does not endorse updating in later rounds of testimony, whether optional or compulsory, because the period allotted for responsive testimony typically does not provide the time needed to verify the accuracy of the updates and evaluate the impact of those updates on capital structure balances and the embedded costs of debt and preferred stock. The period allotted for responsive testimony is simply not the proper time to change a primary case.

In Staff's view, the Company did not provide sufficient justification for altering the parties' primary cases during a responsive phase of the proceeding. The Company's rationale that an update would reflect the more recent market data used to support Staff's Ameren recommendation is without merit. First, obviously, any update would reflect more recent data; that is true at every phase of the proceeding. However, to update at every phase of the proceeding is impractical. Nevertheless, if updates proposed simply for the sake of updating are allowed, the sponsor should update all of the components of the cost of capital. Such an update ensures that the components of the cost of capital are measure consistently in order to avoid selective component updates that may distort the cost of capital. Since ComEd did not update all of the cost of capital components – indeed, it did not even update all inputs into the cost of common equity – we cannot be sure that the cost of capital is not distorted, and is realistic.

Second, the cost of equity recommended by Staff in the Ameren proceeding is simply not relevant in the instant docket. As in any contested rate proceeding, the order for this proceeding must be based exclusively on the evidence in this record. 220 ILCS 5/10-103, 10-201(e)(iv); *BPI I* at 227. Moreover, that Dr. Hadaway does not know of any reason why the Commission should adopt a higher cost of equity for the Ameren utilities than for ComEd does not mean none exists. ComEd Ex. 42.0 at 6. The fact is, the Company failed to demonstrate that the two cases are equivalent. Specifically, Dr. Hadaway's surrebuttal testimony failed to address critical factors that influence Staff's return proposals in the Ameren proceeding. For instance, Dr. Hadaway did not identify the relative risk, as exemplified by credit rating or any other metric, of each of the Ameren utilities. Nor did he identify the capital structures that were proposed or the amounts of the common stock flotation cost adjustments, if any, that were included in each of those cost of equity recommendations. Without such data, any evaluation of Staff's return recommendation in this proceeding via comparison to its return recommendations in the Ameren proceeding is useless, since we have no basis on which to assess comparability. Thus, the cost of capital for Ameren is irrelevant to this proceeding.

3. CUB

CUB states that a utility's required return on equity – that is, the level of profit necessary to attract investment to a business with the utility's level of risk – is a cost of doing business that utilities are allowed a constitutionally protected opportunity to recover. CUB asserts that the terms "return on equity" and "cost of equity" are interchangeable. CUB Ex. 1.0 at 3. CUB recognizes that as with other utility costs, the cost of equity must be reasonable and prudently incurred.

CUB maintains that the record in this case presents a continuum of recommendations for ComEd's return on equity. CUB states that on one end of the spectrum, CUB witness Christopher Thomas recommends a return on equity of 7.77%, based on the results of a DCF model incorporating findings from the most current and advanced studies of financial markets. CUB Ex. 1.0 at 2. CUB further states that on the other end of the spectrum, the Company's witness, Dr. Hadaway, recommends that ComEd receive a return of equity of 10.75%, derived from an average of his DCF,

CAPM, and other risk premium analyses, which incorporate several incorrect assumptions. ComEd Ex. 10.0 at 1. CUB recognizes that Staff witness McNally recommends a return of 10.30%, based on an average of widely divergent results from his DCF and CAPM analysis. Staff Ex. 4.0 Corr. at 7-8.

CUB argues that the risk-based level of compensation for dedicating equity capital to public use is constitutionally required. CUB recognizes that the U.S. Supreme Court has established the requirement that regulated utilities receive a fair return on equity. *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*"); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 US 591 (1944) ("*Hope*"). Together, CUB avers that the *Hope* and *Bluefield* decisions establish that utilities are entitled to an opportunity to earn a fair return on their prudent and reasonable investment that is equal to the returns earned by other firms of comparable risk. CUB Ex. 1.0 at 4. CUB affirms that these legal standards – a risk-based level of compensation and a marketplace cost – to the extent one can accurately determine them, are objective criteria. Thus, CUB asserts that the Commission's determination of an appropriate return is grounded in the relative riskiness of the utility. CUB claims that investors' required returns for investment in an enterprise of a given level of risk will change as the objective factors that define the equity markets change over time. CUB Ex. 1.0 at 4.

CUB states that the Act directs the Commission to: (1) ensure that the cost of equity used to develop rates fairly compensates investors for their risk; and (2) assure that customers do not pay an excessive or unreasonable return in the utility's rates. 220 ILCS 5/9-211, 5/9-230. CUB claims that these opposing responsibilities can be balanced fairly only when the Commission thoroughly considers the objective market factors that determine a fair return on investment and ensures that the utilities' investments are reasonable and prudently incurred. That is, CUB argues that the Commission must give investors the return they require, not the return they prefer.

CUB claims that the ROE that investors require for their investment in ComEd is 7.77%. CUB Ex. 1.0 at 2. CUB argues that while investors may, at times, desire higher rates of return, the utility is only entitled to an opportunity to recover this necessary level of return through regulated rates as a prudently incurred cost. *See* generally Hope; Bluefield; 220 ILCS 5/9-211, 5/9-230. CUB recognizes that the cost of equity is not directly observable in the market for a particular utility. CUB Ex. 1.0 at 20. Therefore, CUB states that financial analysts have developed tools, such as the DCF and CAPM models, to estimate the cost of equity from observable market factors. CUB contends that the expert witnesses in this proceeding used various combinations of these models to develop their cost of equity estimates. CUB maintains that in CUB witness Christopher Thomas' expert opinion, a properly constructed DCF analysis, using the results of the CAPM as confirmation of these results, yields a cost of equity of 7.77%, which represents the return necessary to maintain ComEd's access to equity capital markets on reasonable terms. CUB Ex. 1.0 at 2-3.

CUB asserts that ComEd argues that Mr. Thomas' recommendation is "unreasonably low." ComEd Ex. 29 at 22. However, CUB argues that the evidence demonstrates that investors today take on far less risk, and expect smaller returns,

when they invest in ComEd than they would have in the past. CUB states that examples of dramatic changes in ComEd's risk profile include the spin-off of risky generation assets and the elimination of all supply procurement risk. CUB Ex. 4.0 at 7-8. CUB recognizes that ComEd is even seeking to further reduce its exposure to risk, as evidenced by Riders SMP and SEA filed in this case. Tr. at 1864. CUB claims that because of these dramatic changes, investors are content to demand a lower return to invest in ComEd than the Commission has granted any other Illinois electric utility in the past 30 years. Tr. at 1841.

a. DCF Analysis

CUB states that the cost of equity is not directly observable in the market for a particular utility, even for firms with publicly traded shares. Consequently, CUB contends that financial models have been developed to estimate that cost of equity indirectly from various market factors. CUB maintains that the experts in this proceeding used various combinations of these models to develop their cost of equity estimate. CUB affirms that Mr. Thomas based his return on equity recommendation on the DCF model, thereby avoiding undue dependence on the unreliable CAPM model used by other parties. CUB 1.0 at 19-20. In doing so, CUB argues that Mr. Thomas began with the same sample of comparable utilities used by Dr. Hadaway, but removed eight companies because their level of historic growth is not sustainable. CUB states the inclusion of these eight companies introduces inappropriate bias into the sample. CUB Ex. 1.0 at 21.

CUB claims the DCF model estimates the cost of equity capital by assuming that investors who purchase stock are paying a price that reflects the present value of the cash flows they expect to receive from the stock in the future. CUB Ex. 1.0 at 23. CUB argues the DCF model uses current stock price and expected cash flows from dividends and earnings growth to estimate the return that investors expect to receive. CUB Ex. 1.0 at 23-24. CUB asserts that investors' expectations of growth and cash flows are driven largely by historical experience, because analysts are frequently overly optimistic. CUB Ex. 1.0 at 24-6. CUB recognizes Mr. Thomas' analysis uses current and forecast measures of financial performance as known values in the DCF equation, permitting the analyst to estimate the return on equity required for that performance. CUB argues that while Mr. Thomas did use a second financial model tool, the CAPM, it was only to validate his DCF result. CUB recognizes the result of this analysis demonstrates that ComEd is only entitled to a 7.77% cost of common equity, which represents the return level necessary to maintain the Company's access to equity markets on reasonable terms, as determined by his analysis of relevant, objective market factors, and ultimately provide investors with a fair return on their investment in the Company. CUB Ex. 1.0 at 20.

CUB argues that in a proper DCF model, the growth rate represents a sustainable growth rate due to increased earnings. CUB avers that the Commission should adopt Mr. Thomas' analysis, which estimates the sustainable growth rate using the internal growth method. Consequently, CUB states that Mr. Thomas' analysis avoids reliance on biased analyst growth estimates and takes into account changes in expected dividend payout ratios. CUB Ex. 1.0 at 31-2. CUB claims that CUB, Staff and

IIEC agree that the analysts' are currently producing overly optimistic growth forecasts that are unlikely to be sustainable over time. CUB Ex. 1.0 at 26; Staff Ex. 4.0 Corr. at 13; IIEC Ex. 2.0 at 19. CUB argues that the sustainable growth rate is a critical component of the DCF model, representing the amount of growth that investors expect to occur on their investment, and that is sustainable over the long-term. CUB Ex. 1.0 at 24. CUB professes that setting the growth rate component of the DCF model at an unreasonably high level would result in an estimate of the cost of equity that is also unreasonably high, all other things being equal.

Historically, CUB states that analysts have set their sustainable growth rate assumptions at unreasonably and unsustainably high levels. CUB recognizes that financial researchers have documented this bias extensively, as summarized in Mr. Thomas' testimony. CUB Ex. 1.0 at 24-26. CUB states that Staff and IIEC agree that the use of analyst growth rates unduly bias its cost of equity recommendations. CUB Ex. 1.0 at 26; Staff Ex. 4.0 at 13; IIEC Ex. 2.0 at 19. Therefore, CUB argues that Staff and IIEC have adjusted their approach to estimating the cost of equity by using non-constant and two-stage DCF models to account for the overt optimism of analysts' forecasts. However, CUB contends that these methods involve significant judgment and introduce a degree of uncertainty into the DCF analysis. CUB Ex. 4.0 at 13-4. CUB recognizes that this uncertainty confirms findings in the academic literature that historical growth rates are a far more accurate predictor of expected sustainable growth. CUB Ex. 4.0 at 13-4.

CUB asserts that Mr. Thomas' analysis addresses both this analyst bias and a second form of bias, caused by expected changes in dividend payout ratios, by using the average historic internal growth rate for the sample companies to estimate the sustainable growth rate variable of the DCF model. CUB Ex. 1.0 at 31-33. CUB asserts that when analysts are expecting the dividend payout ratio to change, their forecasts for both dividends and earnings will not accurately represent expected future growth in the DCF model. CUB Ex. 1.0 at 29. Currently, CUB states analysts are expecting dividend payout ratios to change. CUB Ex. 1.0 at 28-9. However, CUB argues that Dr. Hadaway's analysis relies on the use of forecasted earnings to estimate the expected sustainable growth rate. ComEd Ex. 10 at 37. As a result, CUB claims that his analysis relies on inaccurate and highly unreasonable growth rates. CUB Ex. 1.0 at 35-6. Mr. Thomas' estimates of internal growth corrects this inaccuracies and results in a reasonable 3.09% sustainable growth rate for ComEd.

CUB maintains that Mr. Thomas' DCF model analysis is the only analysis in the record that does not double-count the effect of quarterly growth and compounding by making a quarterly adjustment to the expected dividend growth used in the DCF model, because Mr. Thomas conducted his analysis without incorporating an improper adjustment for quarterly dividend payments and compounding. CUB Ex. 1.0 at 36-39. CUB asserts that this double-counting was also recognized by IIEC witness Gorman. However, CUB recognizes that Mr. Gorman's analysis includes the adjustment anyway, because the Commission has allowed it so many times in the past. IIEC Ex. 2.0 at 17.

As Mr. Thomas explains for CUB:

> The Commission sets rates to recover a utility's cost of capital on an annual basis. However, investors receive their dividends quarterly and realize the value of reinvesting their dividends. If the Commission increases ComEd's authorized return to add the value of receiving dividends quarterly instead of annually into its decision, investors will still be paid dividends quarterly and will be able to reinvest them, to receive -- again -- the value added from quarterly growth and compounding. Thus, the quarterly adjustment biases returns upward by double counting them.

The N-Stage Discount Model and Required Return: A Comment, 27 The Financial Review 148 (Feb 1992) (emphasis added) (footnotes/citations omitted)). Consequently, CUB asserts that Dr. Hadaway's analysis, which contains a quarterly DCF model, is incorrect and results in unreasonably high cost of equity estimation. CUB Ex. 1.0 at 37-39.

b. CAPM Verification of DCF Results

CUB contends that the CAPM has several well-known problematic theoretical and practical elements. CUB states that the CAPM contains such substantial bias that it is unreasonable to rely on it to estimate a utility's cost of equity. CUB Ex. 1.0 at 5-6. Consequently, CUB argues that unlike other parties, who average their CAPM results with DCF results to arrive at a final return on equity recommendation, Mr. Thomas uses the CAPM analysis only to verify the results from his DCF analysis. CUB Ex. 1.0 at 9. CUB recognizes that if Mr. Thomas' CAPM and DCF model results differed wildly, then he would check the DCF model for errors or inappropriate assumptions. CUB Ex. 2.0 at 7.CUB affirms that studies by prominent financial researchers have concluded that the CAPM "provides a very unreliable estimate of the cost of capital." CUB Ex. 1.0 at 8-9 (quoting Jagannathan and Meier). Notably, CUB recognizes a 2007 study, referred to in Mr. Thomas' testimony as the "Nagel Paper," casts serious doubt on whether the CAPM model provides a better estimation of the cost of capital than a completely arbitrary model. CUB Ex. 1.0 at 5-6. CUB argues that the Nagel Paper is the most recent research available on forecast error in the CAPM, and corroborates a long history of problems with the CAPM. CUB Ex. 2.0 at 5-8.

Specifically, CUB contends that the Nagel Paper "compared a very simplified version of the CAPM to the mainstream version of the CAPM and five other well-known theoretical models that add more specific risk measurements (such as the factor loadings and expected risk premia mentioned in the following quote) to the traditional mainstream CAPM model." CUB Ex. 1.0 at 5. CUB states that the Nagel Paper concludes:

> [F]orecast error caused by estimating factor loadings and expected risk premia in the more complex models exceeds the precision gained by including the risk factors. In other words, both parametric and nonparametric statistical tests show that increasing model complexity fails to significantly reduce forecast error.

i. The Commission Should Set the EMRP Parameter at 5.0%

CUB declares that unlike other parties in this proceeding, who use biased analyst estimates of the expected market risk premium ("EMRP"), calculated using forecasted growth, Mr. Thomas bases his EMRP estimate of 5.0% on empirical financial research. CUB Ex. 1.0 at 16-19. CUB asserts that this figure represents a single characteristic that is among the most examined in finance – the market premium. CUB argues that this premium, above the risk-free rate, which investors expect when they invest in the market. CUB recommends that this risk premium represents the additional reward that investors expect from investing, not just in a utility, but in any investment, over their return if their money were kept absolutely safe. CUB Ex. 1.0 at 16.

CUB claims that the financial literature is filled with conclusions from prominent researchers who note that analyst-calculated EMRPs often contain significant upward bias. CUB Ex. 1.0 at 16-19. CUB argues that surveys of real, live investors show that a reasonable and accurate estimate of the EMRP that investors expect is in the range of 3.0% to 5.0%. CUB Ex. 1.0 at 18-19. Thus, CUB recommends that the Commission adopt Mr. Thomas' recommendation to use an EMRP of 5.0% when performing the CAPM analysis.

In contrast, CUB recognizes that Staff calculated the EMRP using analysts' forecasted growth rates in a DCF analysis of companies making up the S&P 500. Staff Ex. 4.0 at 24. CUB argues that this methodology suffers from the same deficiencies as Staff's other DCF analyses. That is, CUB asserts analysts have set their sustainable growth rate assumptions at unreasonably and unsustainably high levels. CUB claims that financial researchers have documented this bias extensively, as summarized in Mr. Thomas' testimony. CUB Ex. 1.0 at 24-26. CUB states that Dr. Hadaway calculated EMRP by looking at historic growth rates. ComEd Ex. 10.0 at 34. CUB maintains that this methodology has been proven inaccurate because it is upwardly biased by historical stock market data. CUB Ex. 1.0 at 17-18. Thus, CUB asserts the Commission should use the 5.0% EMRP supported by financial research.

c. Investors Expect Lower Returns than the Commission has Granted During the Last 30 Years

CUB maintains that investors are content to demand a lower return to invest in ComEd than the Commission has granted any other Illinois electric utility in the past 30 years. Tr. at 1841. CUB argues that the evidence demonstrates that investors take on far less risk when they invest in ComEd than they have in the past. CUB states that examples of dramatic changes in ComEd's risk profile include the spin-off of risky generation assets and the elimination of all supply procurement risk. CUB Ex. 4.0 at 7-8. CUB affirms that ComEd is even seeking to further reduce its exposure to risk, as evidenced by Riders SMP and SEA filed in this case. Tr. at 1864. CUB contends that while ComEd focuses attention on the absolute level of the ROE, the absolute level is actually far less important than the risk premium above the cost of debt. Tr. at 1861.

Accordingly CUB argues that granting ComEd anything more than 7.77% would provide investors a return above their cost of capital, which violates the Hope and Bluefield standards.

CUB states that there is no doubt that investors hope for returns above their required cost of capital. However, CUB asserts that while investors may desire higher rates of return, ComEd is only entitled to an opportunity to recover the necessary level of return through regulated rates as a prudently incurred cost. *See* generally Hope; Bluefield; 220 ILCS 5/9-211, 5/9-230. In the past, CUB recognizes that investors' hopes have been fueled by a generally increasing trend in the spread between Commission approved rates of return on common equity and the cost of corporate debt. CUB Ex. 4.0 at 4-5. CUB professes that the Commission has actually been granting increasing spreads at a time when there is actually a decreasing trend in the spread between earned returns on Baa rated corporate bonds and the S&P 500 since the mid 1980s. CUB Ex. 4.0 at 5-6.

CUB states that when you compare the academic evidence to the practical world the Commission has operated in, there is a big disparity. Tr. at 1863. CUB argues that most of this disparity is caused by a level of persistence in Commission decisions. CUB asserts that this persistence is based on a slow incorporation of the academic findings that Mr. Thomas identified. Tr. at 1864. CUB recognizes that the evidence shows that many of the traditional methods that the Commission has employed to estimate investors' required ROEs introduce unnecessary bias. This bias results in decisions above the cost of capital, which is unlawful.

4. IIEC

IIEC's cost of equity expert, Mr. Gorman, recommended a return on equity of 10.2% for ComEd. He developed his recommendation using a constant growth DCF model, a two-stage growth DCF model, a Risk Premium ("RP") model and a CAPM analysis. IIEC notes that because ComEd does not have publicly traded equity shares, Mr. Gorman estimated the appropriate return on equity based on observable market information for a group of publicly traded electric utility companies that approximates ComEd's investment risk (selected by ComEd witness Hadaway).

IIEC states that electric utilities are currently in a temporary period of increased investment, sparking expectations of enhanced short-term growth rates. According to IIEC, this factor affected the expected dividend growth rates used as inputs to the various DCF models in this record, and it compromises the reliability of the constant growth DCF model in this environment. IIEC asserts further that because the current pace of investment cannot continue indefinitely, both rate base increases and expected earnings growth will slow after a period of three to five years. IIEC's Mr. Gorman ultimately concluded that use of the consensus professional analysts' earnings growth rates for the proxy group, as the expected dividend growth input in a constant growth DCF model, was not appropriate in the circumstances of this case. These conclusions were supported, according to IIEC, by the following evidence:

» The consensus professional analysts' earnings growth rates for the proxy group used as the expected dividend growth input to the constant

growth DCF exceeds (over an indefinite period) the maximum sustainable growth rate (5.0%), that of the overall economy, and it is considerably greater than historical growth. (*Id.* at 22:497-501).

» The constant growth DCF assumes a steady growth rate that is inconsistent with the evidence that current new investment driven growth will not continue indefinitely. (*Id.* at 22:489, 22:501).

Therefore, IIEC states, Mr. Gorman performed a two-stage DCF model, to match the expected changes over time in electric utility growth, and capped expected growth at the GDP growth rate.

IIEC states that Mr. Gorman also considered the results of two distinct equity Risk Premium analyses and described the analyses as follows. The RP analyses differed in the market data used to estimate a range for the market risk premium. In the first analysis, the equity risk premium was determined as the difference between the required return (commission-authorized returns) on common equity investments and Treasury bond yields. This risk premium range estimate was added to a projected long-term treasury bond yield for the cost of equity estimate. In the second part of his RP analysis, the equity risk premium was calculated as the difference between commission-authorized returns on common equity and contemporary A-rated utility bond yields. In this second part of his RP analysis, the market risk premium was added to the current 13-week average yield on "Baa" rated utility bonds to derive the estimated cost of common equity. The risk premiums derived for a period of years were used to define a risk premium range of 3.0% to 4.4% in this case. IIEC concludes by noting that Mr. Gorman's Risk Premium analyses produce an equity return estimate in the range of 9.8% to 10.1%, with a midpoint estimate of 10.0%.

In addition, IIEC states, Mr. Gorman also performed a CAPM analysis, which has consistently been part of the Commission cost of equity determinations. North Shore Gas Co., *et al.*, Docket 07-0241 and 07-34 0242 (Cons.), Order, Feb. 5, 2008 at 89. In his CAPM, IIEC avers, Mr. Gorman used a beta factor that is very conservative (high) by historical standards and also reflects a trend of increasing utility betas that is not consistent with utilities' recent efforts to reduce their risk, including fewer risky non-regulated activities. The other CAPM inputs, according to IIEC, included historical and forward-looking market risk premium estimates and a risk-free rate. IIEC reports that based on the average of his historical and prospective market risk premium estimates of 6.5% and 7.0%, respectively, a conservative beta of 0.90 and a risk-free rate of 4.6%, Mr. Gorman arrived at a CAPM return estimate in the range of 10.5% to 10.9%, with a midpoint of 10.7%.

IIEC states Mr. Gorman's recommended return on equity of 10.2% is at the midpoint of the estimated return on equity range (9.8% to 10.6%) defined on the high end by the average of his RP (10.0%), CAPM (10.7%), and constant growth DCF (11.0%) results. According to IIEC, the low end of the range is defined by his two-stage growth DCF analysis, while the high end reflects very high (likely unreasonable) estimates of ComEd's cost of equity. IIEC states that the high end of Mr. Gorman's estimated range also reflects his Risk Premium analysis result because, though the Commission has traditionally relied on DCF and CAPM estimates, those exhibit an

upward bias in current circumstances. IIEC argues that although the risk premium estimate is based on historical evidence, that evidence does provide meaningful information about a utility's estimated cost of equity in today's marketplace, and including it in return on equity estimations will improve the Commission's determination.

IIEC argues that ComEd witness Dr. Hadaway's analyses overstate the required equity return for ComEd. According to IIEC, the principal source of his DCF overstatement is an unreasonable 6.6% expected long-term growth rate that exceeds the current 5% market expectation, reflects historical inflation much higher than current forecasts, and exceeds anticipated growth in the economy as a whole. Further, IIEC says, Dr. Hadaway used his excessive growth rate in a constant growth DCF model that extends the unrealistic growth spike in perpetuity. No company, especially historically slow growth utilities, IIEC argues, can grow indefinitely at a faster rate than the market in which it sells its products. IIEC avers that GDP growth is a very conservative, even overstated, ceiling for the highest sustainable long-term growth rate of a utility. Despite a chance to do so, IIEC argues Dr. Hadaway never demonstrated the reasonableness of his long-term 6.6% growth rate.

IIEC also avers Dr. Hadaway's CAPM and Risk Premium estimates are overstated, because they incorporate stale, inflated interest rates that do not reflect the significant decline in interest rates since his original analysis was performed. IIEC reports that though Dr. Hadaway claimed that interest rates had recently increased Mr. Gorman showed that claim to be incorrect. IIEC says after Mr. Gorman pointed out the contradiction in Dr. Hadaway's own data, Dr. Hadaway distinguished in surrebuttal (rising) corporate bond rates from the falling Treasury rates. However, IIEC argues Dr. Hadaway used forecasted utility bond yields -- not current bond yields -- in his analysis, so his observation does nothing to diminish the validity of Mr. Gorman's criticism. In addition, the forecasted utility bond yield Dr. Hadaway used in his rebuttal testimony update was lower than the projected yield used in his direct testimony -- confirming Mr. Gorman's observation and that Dr. Hadaway's analysis does not reflect current lower interest rates.

According to IIEC, Dr. Hadaway's Risk Premium analysis also incorporates an adjustment for a flawed assumption - - that there is an inverse relationship between interest rates and equity risk premiums. IIEC says academic research shows that the relationship between interest rates and risk premiums changes over time and is not a simple inverse relationship. IIEC argues it is inappropriate to increase equity risk premiums, as Dr. Hadaway does in his estimation analysis, for no other reason than a change in nominal interest rates.

IIEC reports that as an adjunct to his determination of a just and reasonable cost of common equity for ComEd, Mr. Gorman examined ComEd's access to capital, as indicated by its bond credit ratings. His purpose was to confirm that if his recommended cost of common equity is adopted, ComEd's financial metrics will support an investment grade bond rating, providing ComEd access to capital markets on reasonable terms. IIEC says Mr. Gorman's analysis also examined circumstances when the period rates will be in effect -- in particular, implementation of recent legislation that will relieve ComEd of its power cost recovery risk. Although ComEd witness Ms. Abbott disputes

Mr. Gorman's conclusions, ComEd could not identify any specific reason to believe the legislation would not be implemented as intended.

5. Commission Analysis and Conclusion

The Company, Commission Staff, CUB and the IIEC have presented evidence supporting four different values for the Cost of Common Equity and the overall Cost of Capital.

At the high end, ComEd's witness, Dr. Hadaway, contends that 10.75% is the proper value for Common Equity. Dr. Hadaway used a risk premium analysis as well as four different DCF analyses and two CAPM analyses using a sample of 27 electric and gas utility companies.

Staff and Intervenors, IIEC and CUB, arguing that Dr. Hadaway's estimate is too high, point out several problems with his analysis. Staff notes that his company specific growth rate Utility Sample in his DCF analyses has an overall near term growth rate of 6.05% and a long term rate of 6.6% for normally slow growth utility companies. The parties are in agreement that the overall economy, normally faster growing than utility companies, is only expected to grow at 5%. Similarly, in his non-constant DCF analysis, Hardaway used a historical GDP of 6.5% as his estimate of future GDP. Published expectations of future GDP growth are much lower.

We agree with Staff and Intervenors that Hardaway's conclusions, based on the assumption that utility investors expect a sustainable utility growth rate about 20% (6.05/5) greater than the economy as a whole, is unlikely.

Staff also argues that Dr. Hadaway arbitrarily weighted the results of his cost of equity DCF models to reflect only the high end of each calculation. Had he incorporated the full range of the numbers from his studies, their midpoint would be 10.35% (almost identical to Staff's conclusion of 10.3%) instead of the 10.75% that Hadaway advocates.

In a similar manner his risk premium analysis is skewed upward. He uses a 27 year period when interest rates were, on average, far higher than they are now, to calculate future bond yields. According to Staff and IIEC, choosing such an extensive time period with a wide divergence from current conditions, inappropriately inflates the value he derived.

CUB presented evidence from Christopher Thomas. CUB argued that the methods we have traditionally accepted to estimate the cost of common equity have an upward bias when compared to real historic results. Mr. Thomas cited several academic journal articles in support of this point of view.

His recommendation of 7.77 % for common equity resulted from a DCF analysis. His utility sample eliminated those companies in Dr. Hadaway's study that had a dividend payout exceeding their earnings per share in any year during the period of his analysis. Eliminating those companies from the sample significantly lowered the derived value for the cost of common equity.

Staff argued that this DCF analysis incorrectly used annual dividend payments in a financial model that requires the incorporation of quarterly dividends. Using annual

numbers reduces the derived cost of equity. CUB argues that using quarterly dividend payments double counts the returns to investors and produces results that are higher than those that actually occur. Staff notes that the annual DCF model he employed has been explicitly rejected by the Commission in previous cases.

Thomas used historical data rather than forecasted growth rates. Thomas cited several publications in support of this methodology which deviates from the standard calculation. Staff and ComEd argue that the point of using analyst's estimates rather than historical data is that the model seeks to incorporate investor expectations rather than actual historic growth. They contend that analyst's expectations of growth are the accepted proxy for investor expectations. Deviation between expectation and actual observed values is acceptable in the DCF model.

Thomas also criticized Staff's use of CAPM analysis citing an article referred to as the "Nagle Paper" that indicates that this modeling tool should not be used to directly calculate return on equity. Staff and ComEd agree that the analysis in the Nagle paper is not applicable here because the calculation traditionally used by the Commission incorporates adjusted rather than raw "betas." Betas are numbers representing the volatility of stock prices. CUB counters that the Nagle paper says adjusted betas are less accurate than their unadjusted counterpart. He concludes that CAPM analysis is not a valid measurement tool.

Thomas admitted that the methods of calculation he advocated are based on academic studies that have not been adopted by any regulatory authority in the United States. He also admitted that the 7.77% that he advocates is lower than any cost of common equity determined by the Commission in 35 years or more.

IIEC presented the testimony of Mr. Gorman. He recommended a return on equity of 10.2%. He derived this number by using two different DCF models, a Risk Premium Analysis, and a CAPM analysis. He used the same sample companies as ComEd's Dr. Hadaway used in his analyses. The 10.2% value that he advocates is the midpoint of the return on equity values he obtained for his four models of 9.8% to 10.6%.

In response to Mr. Gorman, Staff notes that the Commission rejected risk premium analysis in the recent Peoples Gas case, Docket No. 07-0241/07-242 consol and suggested that its acceptance by the Commission in Docket 05-0597 was an anomaly. Staff asserts that if IIEC's risk premium analysis is discarded, Mr. Gorman's cost of equity estimate would rise to 10.3%, which is the same number that Commission Staff believes is appropriate.

Commission Staff analyses used DCF and CAPM analyses on a sample of nine companies whose financial conditions are similar to ComEd. Using a multi-stage DCF growth model Commission Staff calculated a cost of common equity of 9.35%. Staff's CAPM analysis produced a value of 11.25%. Averaging these values produces a cost of common equity of 10.3%.

Although IIEC's DCF analysis is logical and well reasoned, consistent with our ruling in Docket 07-0241/0242, we are not convinced risk premium analysis is an appropriate tool in rate making.

After careful consideration, we find that ComEd's value of 10.75% is higher than justified by the record before us. CUB's value of 7.77% was derived by using novel methodology inconsistent with that recognized as acceptable by this Commission and other regulators. The Commission rejects CUB's determination. We find and conclude that Staff's estimate of the cost of common equity of 10.3% is supported by the evidence and consistent with IIEC's calculation (minus the Risk premium analysis).

D. Overall Cost of Capital (Derivative)

Upon incorporation of the conclusions stated above, the Commission finds that ComEd's capital structure and cost of capital, resulting in overall cost of capital of 8.36% may be summarized as follows:

Class of Capital	Proportion	Cost	Weighted Cost
Long-term debt	54.96%	6.78%	3.72%
Common Equity	45.04%	10.30%	4.64%
TOTAL	100.00%		**8.36%**

The Commission finds that this overall cost of capital to be just and reasonable and should be used for purposes of ComEd's authorized rate of return on rate base in this proceeding.

E. Effects of Riders SMP and SEA on Cost of Capital

1. ComEd

ComEd recommends that the Commission reject the proposal to make a downward adjustment to ComEd's return on equity in the event that Riders SMP or SEA are approved. Dr. Hadaway explained that no such downward adjustment is warranted and that the 10.75% return on equity he recommends is appropriate whether or not the Commission approves Rider SMP. ComEd Ex. 29.0 at 23-24.

ComEd notes that IIEC continues to propose a 0.5% reduction in ComEd's cost of equity if Riders SMP and SEA are approved. IIEC Init. Br. at 43. However, IIEC refers to no analysis supporting the proposed reduction, because there is none. Similarly, ComEd added that AARP and the Commercial Group argue for the first time in their initial briefs that an unspecified downward adjustment to ComEd's return on equity should be made, but refer to no analysis supporting any proposed adjustment.

ComEd states that the record does not support adoption of a downward adjustment to ComEd's return on equity in the event that Riders SMP or SEA are approved. Dr. Hadaway's testimony specifically considers the issue and concludes that the 10.75% cost of equity supported by his analysis is appropriate whether or not the Commission approves Rider SMP. Thus, ComEd concludes that there is no contrary analysis on which any proposed downward adjustment could be based.

Because there is no evidence supporting a proposed adjustment, ComEd recommends that the Commission reject it. ComEd states that it and Staff agree that

there is no basis for reducing ComEd's return on equity or overall rate of return on rate base assets if Riders SMP or SEA are approved. ComEd concludes that the Commission should enter an order that is consistent with the evidence and decline to adopt the proposed downward adjustment to ComEd's overall return.

2. AARP

If the Commission decides to adopt some version of ComEd's proposed Rider SMP or its proposed Rider SEA, AARP suggests that the adoption of these mechanisms should be accompanied with a corresponding reduction to the authorized return on equity, as recommended by IIEC witness Gorman and by AG/CUB witness Brosch. However, rather than attempting to calculate the appropriate downward adjustment for ComEd's lessened risk, AARP believes that it would be far preferable for the Commission to simply reject these two riders.

3. CG

Unlike other capital investments made between rate cases, ComEd would recover the carrying cost on capital investment made in SMP facilities between rate cases. Tr. at 418. This significantly shifts risk to ratepayers. The SEA rider likewise would shift risk for all storm expense to ratepayers. AG/CUB Ex. 4.0 at 49. Given that SMP investment could be substantial ($1 billion or more), to the extent the Commission approves the SMP rider or SEA rider, this decreased risk to ComEd should be reflected in a lower allowed return on equity.

4. CUB

CUB contends that Mr. Thomas' recommendation to limit the cost of capital on Riders SEA and SMP investments to the cost of long term debt is actually conservative and the Commission may find that other, additional measures are necessary to remedy the concerns expressed by the parties. CUB Ex. 1.0 at 46.

As a result, CUB recommends that the Commission adopt Mr. Thomas' recommendation that if either Rider is approved, the Company should receive a cost of capital on any investment made under Rider SEA or SMP that is equivalent to the Company's embedded cost of long-term debt, 6.74%. CUB Ex. 1.0 at 46. CUB asserts that this return will allow ComEd access to the capital they need to finance projects under SMP and SEA, while recognizing the dramatically reduced risk to the company. CUB recognizes that Staff witness Michael McNally said it best.

CUB argues that if implemented appropriately, an adjustment would not penalize ComEd, but rather would fairly compensate ComEd through an accurate reflection of its true cost of capital in rates. Indeed, if Rider SMP was adopted and ComEd's risk fell, rate payers would be penalized if no adjustment were made.

CUB declares that both riders SMP and SEA will significantly reduce ComEd's risk when investing capital under the Riders. CUB recognizes that this risk reduction is significant because investors are protected from the possibility that they will fail to recover their investment. CUB Ex. 1.0 at 46. In addition, CUB argues that as Mr.

Brosch testifies, only the costs associated with the proposed riders are passed along to customers. CUB claims that ComEd's shareholders keep the benefits of all cost savings as the riders are proposed. AG-CUB Ex. 1.0 at 19.

5. Staff

Staff disagrees with ComEd that a downward adjustment to the cost of equity if Rider SMP is approved would penalize ComEd. ICC Staff Exhibit 17.0 at 20. To the contrary, Mr. McNally explained that if Rider SMP were approved and it reduced risk, ratepayers would be the ones penalized if no adjustment were made. Staff witness McNally explained that if implemented appropriately, an adjustment would not penalize ComEd, but rather, would fairly compensate ComEd through an accurate reflection of ComEd's true cost of capital in rates. *Id*.

Staff's position is that there should be no adjustment to the cost of equity for rate base assets, but a downward adjustment to the rate of return for Rider SMP assets would be appropriate for each Rider SMP component the Commission adopts that would reduce risk. The basis for this position is that if adopted, Rider SMP would create two classes of assets from a risk perspective; rate base assets and Rider SMP assets.

Nonetheless, Staff has not presented a specific cost of equity proposal for Rider SMP assets because Staff is not aware of an appropriate means to quantify and price the risk differential between Rider SMP projects and rate base assets and because the proper cost of equity would be a function of how the rider would operate. ICC Staff Exhibit 17.0 at 18-19. For instance, recovering the capital costs of Rider SMP projects would reduce regulatory lag and, thus, decrease risk. Further, the inclusion of a true-up mechanism and the exclusion of a provision for sharing operating cost savings with ratepayers would each decrease risk. In contrast, the inclusion of a rate cap that would discontinue recovery of Rider SMP costs if the utility's earnings were above the authorized rate of return would increase risk. All of these risk implications would have a cumulative effect on cost of common equity. *Id*. at. 20.

6. IIEC

IIEC views the essential objective of ComEd's proposed riders as providing ComEd greater assurance that its rates -- augmented by rider surcharges -- will provide revenue to cover (and perhaps exceed) its costs of service, without the moderate risk of non-recovery and the regulatory lag that are part of Illinois' traditional rate regulation process. The business risk of the utility, IIEC says, is recognized in its cost of capital determination. According to IIEC, the effect of the riders would be to reduce the riskiness of the utility and increase rate volatility for customers.

IIEC argues that because the market required return on common equity is a function of financial risk and operating risk, investors require a lower rate of return for investments of less risk. Accordingly, IIEC says, the Commission's determination of ComEd's required rate of return must recognize the change in ComEd's riskiness, if the riders are approved, through a reduction in ComEd's authorized return on equity. IIEC's

cost of equity expert Mr. Gorman recommends a reduction to ComEd's authorized return on common equity in the range of at least 0.5% if the riders are implemented.

IIEC notes that ComEd's cost of equity witness, Dr. Hadaway, took the position that no downward adjustment is warranted if Rider SMP and Rider SEA are approved. In testimony, he deems the return on equity he recommends appropriate whether or not the Commission approves Rider SMP. ComEd Br. at 65. However, IIEC argues, ComEd never denies that the utility's risk will decrease if the riders are approved; it simply criticizes others parties' attempts to address that substantive reality, while declining to offer an opposing estimate of the effect.

Dr. Hadaway's implicit assertion that there would be no effect on ComEd's cost of equity defies common sense, in IIEC's opinion. IIEC contends that ComEd has asked for approval of Rider SMP specifically because there is an anticipated effect on the utility's ability to fund SMP projects from external sources and that Rider SEA is a virtual guarantee that ComEd will recover certain broadly defined operations and maintenance costs. Thus, IIEC argues, the fact that regulatory lag and non-recovery risks are eliminated for the potentially enormous cost quantities covered by the riders unavoidably affects the Company's riskiness. IIEC concludes that ComEd, which has the burden of proving that its proposed cost of equity is reasonable, has failed to recognize the reduction in riskiness attendant to its requested approval of Rider SMP and Rider SEA.

IIEC contends its proposal is superior to CUB's and Staff's approach (a distinctive return for SMP assets) because only IIEC's is consistent with the way the capital markets will view the riders' impact. According to IIEC, ComEd's witnesses McDonald and Abbott confirmed that the effect of Rider SMP and the planned SMP assets could not be neatly compartmentalized, that the market would not treat the outside capital needed to fund SMP projects as separate, and that the effect on ComEd's credit ratings will be for the entire undifferentiated utility, not just SMP assets and operations. IIEC's recommendation for a reduction in ComEd's cost of equity recognizes these facts.

7. Commission Analysis and Conclusion

The Commission has considered the arguments on the effect that approved SMP projects will have on ComEd's rate of return. ComEd argues that no reduction in the cost of capital is appropriate. Staff believes that there should be a lower rate of return on SMP assets but does not know how it could be quantified. CUB argues that the rate of return on SMP assets should be limited to ComEd's cost of long term debt, 6.74%. IIEC argues that the marketplace will not distinguish between SMP projects and other assets in rate base. IIEC contends that an overall .5% reduction in the cost of capital is appropriate.

There is no analysis in the record supporting any specific percentage. In the absence of a concrete proposal from ComEd establishing the amount that would flow through the rider during a specific time period, we have no basis to determine what effect, if any, that project would have on the Company's cost of capital. The Commission therefore reserves the right to make a determination on possible

modifications to the cost of capital for SMP assets or overall cost of capital for ComEd and the return on equity for ComEd at the time that ComEd re-files Rider SMP.

VII. New Riders

A. Rider UF

ComEd proposes revisions to its tariffs so that the uncollectible factors will be provided in a new rider, Rider UF, and the tariffs under which customers receive electric service reference this rider as applicable. Staff and Intervenors have not challenged these proposed revisions. Accordingly, the Commission finds ComEd's proposed Rider UF and revisions to related tariffs to be just and reasonable.

B. Rider SMP – Systems Modernization Projects Adjustment

1. ComEd

ComEd states that Smart Grid technologies are the future of the industry and are necessary to support the continued economic growth and prominence of an international city like Chicago, and its surrounding region. ComEd believes that those technologies offer significant benefits to customers, utilities, the competitive market and the environment.

To be able to deliver those benefits, ComEd proposes a regulatory mechanism, Rider SMP, that both provides regulatory certainty about the prudence of those investments before they are made and allows ComEd timely cost recovery of its capital costs. ComEd also proposes a pre-approval process for Smart Grid projects that ComEd says will incorporate meaningful workshop participation by stakeholders and Commission approval of the specific SMP projects proposed by ComEd.

ComEd states that the approval of ComEd's Rider SMP proposal would be a reasonable exercise of Commission rider authority because the SMP costs involve very substantial expenditures which will not be known with any certainty until the Commission is presented with specific projects from time to time. ComEd believes that rider treatment is particularly suitable here where the workshop process could change the contours, as well as the costs, of specific projects ComEd might propose.

As to the amortization period, ComEd requests that, if the Commission approves Rider SMP, the Commission should specifically approve the recording by ComEd of regulatory assets for the costs of assets not fully depreciated but retired early as a result of projects implemented under the rider, and authorize ComEd's recovery of those costs. Staff agrees. ComEd, in the interests of narrowing the issues, accepts Staff's proposed tariff language on this subject. ComEd believes that an amortization period of no more than 10 years is appropriate for meters retired early due to an AMI project, but ComEd recognizes that under Staff's proposed language, the period would be set when the project is approved.

ComEd notes that Rider SMP has evolved throughout this case in response to evidence submitted by Staff and Intervenors, as well as guidance from the Commission in the Peoples Gas case. ComEd also presented evidence about how specific potential SMPs could meet the Peoples Gas criteria. ComEd pointed out that, although there are

disagreements as to the rate treatment, most parties expressly agreed that Smart Grid technology is desirable.

ComEd revised its proposal to address the concerns of Staff and parties while preserving the cost recovery and regulatory certainty required to make the Smart Grid possible. The revised Rider SMP reflects efforts by ComEd to achieve workable compromises that address valid concerns of all participants in the case, including ComEd. Among the revisions ComEd has agreed to during the course of the case are:

1. ComEd has withdrawn its original request for approval of specific SMP projects in order to accommodate greater stakeholder input prior to the start of the formal Commission review and pre-approval process. Specific projects will now be proposed in the workshop process for subsequent review by the Commission following stakeholder input.

2. ComEd has agreed to the 6-month workshop process proposed by CNE to address the legitimate concerns of stakeholders for a robust opportunity to participate prior to project approval. ComEd has agreed that the workshops could be conducted by a third party facilitator.

3. ComEd has agreed to certain modifications for the structure of Rider SMP to assure that the rider works to the benefit of stakeholders. ComEd revised Rider SMP based on the proven model for recovery of capital costs of water utilities; increased the period of annual project reviews; agreed to a biennial filing schedule; agreed to a prudence review; agreed to submit quarterly reports to Staff; agreed to internal audits; and agreed to cost recovery based on a percentage of distribution charges.

4. ComEd has agreed to a full biennial schedule of approvals through a set of stakeholder workshops.

ComEd therefore considers the revised Rider SMP a synthesis of the most reasonable recommendations for evaluating and implementing Smart Grid, while recognizing the reality that ComEd cannot invest the hundreds of millions in this technology without the requisite regulatory certainty and recovery of its costs. ComEd stated that the revised Rider SMP involves little risk to ratepayers or otherwise because not a dime will be collected in rates and nor will any particular project become an SMP project without specific Commission approval and the opportunity of all stakeholders to make their views known.

ComEd urges the Commission to reject proposals for collaborative processes that go beyond addressing technologies that involve an open-ended time frame, amorphous agendas or ill-defined objectives, or that delve into broad theoretical precepts such as the definition of basic service or minimum service. ComEd considers these proposals unnecessary, and asserts that they would defeat any regulatory certainty associated with the process and will have the effect of needlessly delaying, perhaps indefinitely, the deployment of Smart Grid technology in Illinois.

ComEd and Staff disagree on the amortization period for retired assets if Rider SMP is approved. ComEd continues to believe that an 18 year amortization period is reasonable for retired meters. ComEd Ex. 25.0 Corr. at 77; ComEd Ex. 40.0 Corr. at

34. ComEd also does not agree with Staff's proposal that Rider SMP become a pilot program or that Rider SMP itself be the subject of any collaborative proceeding. Staff Int. Br. at 80-81. ComEd states that either of those proposals would undermine one of the most important objectives ComEd has repeatedly insisted upon: regulatory certainty.

Costs included in the rider – At the time of its next general rate case, ComEd anticipates including the costs of the applicable projects in rate base and simultaneously removing those projects from the rider. Houtsma/Frank Direct Ex. 7.0 at 23

2. CNE

CNE presented the testimony of David I. Fein, who explained that "Smart Grid" technologies such as Advanced Metering Infrastructure ("AMI") can provide benefits to customers, competitive retail electric suppliers ("RES"), curtailment service providers, and others. Mr. Fein explained that AMI and other Smart Grid technologies can provide customers and RESs with access to information and data regarding the manner in which a customer is using electricity, thereby allowing the customer to alter those patterns or take advantage of variables in the marketplace. CNE emphasizes that in order to bring the benefits of AMI and other Smart Grid technologies to the greatest number of Illinois customers, it is essential that any such projects be competitively neutral, which is best achieved with stakeholder involvement.

Constellation urges the Commission to approve Rider SMP as a cost recovery mechanism in the current proceeding, and establish a schedule for the collaborative stakeholder process for discussion and evaluation of projects consistent with the timeline recommended in Constellation's rebuttal testimony and as refined in ComEd witness Crumrine's surrebuttal testimony. CNE Ex. 2.0 at 4-5. CNE indicated that evaluating potential Smart Grid technologies through a collaborative stakeholder process has the following advantages: First, collaborative stakeholder processes have been used successfully in the past, on a number of different issues. Second, the collaborative stakeholder process provides the greatest opportunity for stakeholders to provide meaningful input to shape what is ultimately proposed for Commission approval. Third, a collaborative process affords parties the opportunity to work together to answer questions and explore alternatives, and is likely to be significantly less costly than fully litigating all of the issues associated with the potential initiatives.

3. RESA

RESA witness Boston testified that it is important that the Commission provide incentive for ComEd to make the advanced infrastructure investments that ComEd has indicated it will make through its proposed Rider SMP. RESA therefore supports the proposal of CNE that the Commission approve the essential features of Rider SMP in this proceeding, while providing a means for additional stakeholder input into the investments themselves through a subsequent workshop process.

Mr. Boston testified that RESA has a strong interest in how ComEd invests in AMI because RESA members serve a wide range of customers, from residential and small commercial customers up to large industrial customers. Providing advanced metering technology to ComEd's customers will allow RESA members to offer their

customers new and innovative services to control their energy usage that are not possible under the current metering technology. RESA believes that the infrastructure investments ComEd plans to make under Rider SMP will therefore benefit customers and enhance competition for the supply of energy. Utilization of the workshop process and subsequent Commission review will provide a mechanism to ensure that investments under Rider SMP are just and reasonable.

RESA notes that all customers will benefit from the use of AMI because it will result in using electricity more efficiently and thus help delay the need for new generation, make existing generation more efficient, and even result in a decline in the amount of generation used per customer. Thus, it is not unreasonable to design a recovery mechanism that applies to all classes of customers.

4. BOMA

In testimony, BOMA provided qualified support to approving Rider SMP as a cost-recovery mechanism-- such qualified support hinging on the ability of customers to access timely detailed information. BOMA also advocated for a collaborative process to assure the needs of the customers are properly provided, and addressed the critical need for ratepayers/customers and their authorized agents be provided with equal access to the information generated through upgraded technology.

As sophisticated customers BOMA agrees with ComEd witness Crumrine and CNE witness Fein that stakeholders share a common goal with smart grid technology. BOMA expressly agrees with CUB witness Cohen that smart grid technology, to the extent such projects are approved, be accomplished in a way that guarantees consumers are the primary beneficiaries.

In BOMA's view, many smart grid technologies are inevitable, especially in this information age. BOMA understands some parties' concerns of by-passing the traditional ratemaking process, but states that if accomplished properly, Rider SMP provides a vehicle to implement customer-beneficial technologies sooner rather than later.

BOMA testified that taking into account customer benefits through access to timely, detailed information, the cost-benefit analysis of Rider SMP improves significantly. BOMA Ex. 3.0 at 2. Neither the information provided currently nor the information proposed by ComEd to be provided to customers is sufficient. BOMA Ex. 3.0 – 3.4; 5.0 – 5.3. Clearly, BOMA opines, smart grid infrastructure becomes a critical resource in the Illinois' energy infrastructure in providing information to customers to mitigate market risk.

Finally, BOMA provided detailed information as to specifics of AMI and demand response technology. In BOMA's view any metering and telemetry projects must fundamentally adhere to ComEd's hand-picked system operator's rules and requirements for customer participation in electric and grid markets. *See* BOMA Ex. 5.0 at 18-21.

BOMA urges the Commission and ComEd to anticipate future requirements for information before dictating rules. Without appropriate forethought, BOMA argues, an

AMI and information access system could, instead of adding value, undermine ratepayers' ability to access beneficial system resource markets. Finally, because of the lack of specificity or adherence to system operator rules, BOMA advocates a stakeholder process to address specific technical requirements as well as accomplish customer goals and objectives in this new information era.

5. AARP

According to AARP, the most amazing aspect of Rider SMP is ComEd's admission that extraordinary ratemaking treatment is being requested for projects that are not necessary for basic electric service. Also, examples of SMPs that have been mentioned during this case have included projects that would provide services available only at the request of a customer and projects that could be developed into new competitive services, such as Broadband over Power Lines. AARP contends, as a matter of law and as a matter of sound ratemaking policy, that ComEd's delivery service customers should not be forced to subsidize services that exceed basic electric service, much less should they be required to contribute to such services through an extraordinary mechanism that operates outside of the protections provided by a general rate case procedure.

AARP also has legal objections to Rider SMP. AARP notes that Section 9-211 of the Act requires that the determination of any rate or charge shall include only investment that is prudently incurred and is used and useful in providing service to customers. 220 ILCS 5/0-211. Also, Section 215 of the Act charges the Commission with the task of determining whether a utility's capacity is in "excess of that reasonably necessary to provide adequate and reliable electric service." 220 ILCS 5/9-215. Section 8-401 of the Act requires Illinois public utilities with providing service and facilities in a manner that constitutes the "least cost of meeting the utility's service obligations." 220 ILCS 5/8-401.

According to AARP, this legal framework for ratemaking would be violated by ComEd's proposal to fund projects and optional services which exceed its basic obligations through a mandatory surcharge. Rider SMP is fundamentally at odds with Illinois law, especially if it were approved as an "empty rider" with particular projects to be determined through a subsequent proceeding. Such a decision would establish a blank check that would be filled in later—outside the full review and protections provided to consumers by a general rate case.

Moreover, AARP argues that Rider SMP would be bad ratemaking policy because it represents an unusual, unnecessary, and one-sided "single issue" ratemaking proposal that inappropriately distorts the ratemaking calculus and should therefore be rejected. It would shift the risk of funding distribution system improvements away from shareholders and onto ratepayers by making ratepayers responsible for all SMP-related revenue requirement equivalent amounts occurring between rate cases.

AARP is also concerned that this rider would remove or reduce incentives to prudently control the cost of plant additions. One of the useful functions of regulatory lag is that it places financial responsibility upon the utility for fluctuations in costs between rate cases. Because of the lag between placing new plant into service and

obtaining rate recognition of such plant, the utility may bear the cost of new plant additions temporarily. This can encourage management to emphasize cost control to a higher degree than might be expected if cost responsibility for plant additions during the periods between rate cases were shifted away from the utility and onto ratepayers. These incentives that are currently in place would essentially be eliminated if Rider SMP were to be approved.

Another concern with the proposed Rider SMP is that it excludes any consideration of operating expense reductions enabled by the plant additions. By focusing on only certain isolated components of the revenue requirement formula, and ignoring offsetting components, Rider SMP would unfairly produce rate increases without capturing offsetting benefits, such as expense reductions. AARP Ex. 1.0 at 9.

ComEd's proposed Rider SMP would also distort test year relationships. In rate of return regulation, it is important to use a test year where each element of the revenue requirement is properly matched and coordinated. ComEd's Rider SMP would distort the relationships between the components of the ratemaking formula by focusing on select elements which *increase* the revenue requirement – selected distribution system plant additions and depreciation expense and taxes on such additions – without considering other components, such as increased revenues and other expense changes (that may *decrease* the revenue requirement) in a balanced manner.

Rider SMP would produce additional increases annually in an unbalanced manner that considers only one component of the revenue requirement—essentially single-issue ratemaking. The lack of a Rider SMP in the past has not deterred ComEd from making the necessary investment to meet its service obligations to its customers. *See* AARP Ex. 1.0 at 13. Consequently, it is not appropriate to now set aside this one single issue for future recovery, providing what essentially would amount to a guarantee of future return on distribution plant investment.

It will be no comfort to AARP if an "empty" Rider SMP is approved in this case with a separate proceeding established to review potential projects for special treatment through inclusion in that rider. Many AARP members desire only basic electric service and will likely resent an unfair ratemaking system that forces the payment of extra charges in order to fund services that may benefit a small number of customers. Moreover, as an organization, AARP will find it burdensome to intervene in additional proceedings, and to fund legal and consultant participation, in order to represent the interests of its members as residential customers. As for having the ability to participate meaningfully in Commission rate proceedings, AARP would much prefer to have significant capital improvements continue to be addressed in the context of general electric rate cases, rather than through a separate rider that may involve annual proceedings, each carrying the risk of rate increases for its members within the ComEd service territory. AARP Ex. 2.0 at 7-8.

The record in this case contains no information about mechanisms in other jurisdictions which approximate the proposed SMP Rider, other than some general references at the evidentiary hearing to SmartGrid initiatives in the state of California. Responses to data requests AARP 1.08, AG 2.18 and AG 2.20 stated that neither ComEd nor any ComEd witnesses have conducted any specific research into any rider

or any tariffs approved for an electric utility in other jurisdictions to determine any similarities to ComEd's proposed Rider SMP. AARP notes that there are, however, other electric utilities that have begun implementing SmartGrid projects and other new distribution technologies on an experimental basis *without* seeking advanced regulatory approval for an extraordinary ratemaking mechanism. Xcel Energy has recently announced its plans to implement an advanced, smart grid system in Boulder, Colorado. AARP Ex. 2.1 (Xcel's March 12, 2008 Announcement). Having established a collaborative effort with other firms and leveraging other resources including governmental grants, Xcel anticipates funding only a portion of the smart grid project itself. Additionally, as reported recently in the Wall Street Journal, Xcel is not seeking permission from regulators to recover its costs in advance, but will wait until it has assessed and proven the benefits. AARP Ex. 2.2. The approach advanced by Xcel, where the utility is assuming the initial risks of installing smart grid technology and evaluating whether it is producing benefits, stands in stark contrast with ComEd's approach. AARP Ex. 2.0, p. 6. If ComEd wants to be a pioneer in testing smart grid technologies, perhaps it should take an approach more like the one that Xcel is using — one that maintains the initial risk with utility shareholders and collaborators, and does not shift risk onto ratepayers.

6. Nucor

Nucor argues the cost of distribution projects that ComEd would have designated as SMPs should be recovered through ComEd's distribution rates — not a special cost-tracking mechanism that: 1) requires stakeholders to participate in annual mini-rate cases to protect their interests; 2) ignores ComEd's overall financial position, and instead imposes a single-issue ratemaking scheme that targets selected investments for special ratemaking treatment; and 3) reduces ComEd's incentive to operate efficiently. Nucor urges the Commission to reject ComEd's proposed Rider SMP.

7. Kroger

It is Kroger's position that Rider SMP is a classic example of single-issue ratemaking and therefore should be rejected. Kroger asserts the Rider SMP proposal does not rise to the level of compelling public interest that would warrant single-issue ratemaking.

Kroger argues that as a public utility, it is ComEd's responsibility to provide safe and reliable service to its customers. In meeting this responsibility, ComEd must set budget priorities and invest sufficient capital to maintain and improve its system. ComEd indicates that it is proposing the SMP, in part, as a way of preventing "higher priority" capital projects from displacing system improvement projects. If system improvement projects are prudent investments, then management should fund them and seek cost recovery through conventional ratemaking treatment. If Rider SMP is adopted, and if there are projects which are construed to be of "higher priority" which ought to be funded, but which are not being funded due to capital constraints, then it seems to Kroger that it would be a misallocation of resources to ensure funding through Rider SMP of projects that (by definition) are of lower priority. It is not in the public

interest to resort to single-issue ratemaking to ensure capital funding of projects that may be worthwhile, but which are of somewhat "lower" priority in the Company's capital budgeting process.

8. AG

The AG states that a critical fact in evidence for Commission consideration of the Rider SMP proposal is the Company's pronouncement that the projects that would be financed by Rider SMP are not necessary for the provision of reliable electric delivery service. ComEd views Rider SMP as the cost recovery mechanism for projects that "reflect ComEd's current vision for a distribution system of the future." ComEd Ex. 14.0. Accordingly, Rider SMP will trigger quarterly rate increases to cover a return of and on plant that is admittedly not necessary for the provision of safe, reliable, efficient distribution service.

In its proposed form, the AG argues that any growth in spending on approved SMP projects translates directly into higher future prices for consumers. These line-item rate increases would occur outside of a rate case, with cost recovery computed each month based on actual incremental capital investments from the last calendar quarter. Rider SMP adjustments would apply to all retail customers, and would be imposed as a "percentage of other charges" instead of on a kWh basis as initially proposed. ComEd Ex. 30.1, 1st Revised Sheet No. 626. The AG points out that ComEd's proposed rider approach to financing its new capital investment would enable the Company to achieve a Commission declaration that the proposed plant investment is used and useful and prudently incurred before the Company spends a dollar on the proposed capital addition. ComEd would achieve this preferential ratemaking treatment without having to account for generalized productivity growth, any specific cost savings associated with such higher capital spending and any other changes in its revenue requirements.

ComEd witness Crumrine states, "The intent of this rider is to treat the capital costs of these projects in a similar manner as the Commission would in a rate case, but with more timely recovery between rate cases." ComEd Ex. 11.0 at 17. As noted by AG/CUB witness Brosch, however, this more "timely" recovery simply means that ratepayers pay higher prices sooner than would occur under traditional test period regulation, with ratepayers assuming the risk of investing prudently normally borne by the Company and its shareholders. AG/CUB Ex. 1.0 at 19. ComEd estimates annual Rider SMP capital investment ranging from $28.9 million in 4th Quarter, 2008 to $294 million in 2010, and then $250 million in 2012. ComEd Ex. Corr. 43.1 at 2. These figures translate into annual revenue requirement figures of $9.6 million in 2009 to $120 million in 2012, over and above the overall revenue increase granted by the Commission in this case. *Id*.

After Staff and Intervenor witnesses registered various objections -- both on legal and factual bases -- to the Company's specific Rider SMP project proposals, the Company withdrew its request for approval of specific Rider SMP projects. Thus, ComEd is requesting Commission approval of Rider SMP with no specific projects or capital additions attached to the rider. Tr. at 83-84. Included in this request is a specific schedule for biannual workshops and docketed proceedings that ultimately would result

in Commission approval of specific, ComEd-proposed Rider SMP projects through a six-month proceeding beginning in May of 2009. *Id*. The AG points out that even under ComEd's revised proposal, ComEd would still obtain a specific Commission declaration that the projects to be financed through Rider SMP are both prudent and used and useful. *See* ComEd Ex. 43.0 at 5-7; Tr. at 95.

The Company proposes an annual reconciliation proceeding, in which the Commission would examine the reasonableness of Rider SMP project costs. *Id*. In this docketed proceeding, the Commission would also review ComEd's earnings to determine whether Rider SMP refunds are in order (not to exceed the amount of SMP surcharges) if it is determined that the Company's reported earnings exceeded the rate of return established in the last rate case. Tr. at 1920.

AG/CUB witness Brosch states that Rider SMP fails every one of the general criteria that are routinely relied upon by regulators to evaluate rider proposals and highlighted by Illinois courts as appropriate for rider recovery. The costs associated with return on and return of SMP capital investments (return and depreciation) are: 1) not large in relation to the overall revenue requirement; 2) not volatile in amount; and 3) not beyond the control of utility management. AG/CUB Ex. 1.0 at 32. An example of this can be seen in ComEd's revenue requirement amounts, where the level estimated by ComEd is not significant to ComEd's future financial stability. Projected Rider SMP amounts represent only 0.4 percent in 2009, growing ultimately to about 4.1 percent of the Company's total $2.2 billion revenue requirement. AG/CUB Ex. 1.0 at 32-33. The AG argues that after five years without a rate case to evaluate overall earnings and revenue requirement, it would be wholly inappropriate for customers to be charged $120 million through Rider SMP in 2012, for example, for piecemeal technology investments with no accounting for cost savings and other benefits enabled by such technology.

Another problem with Rider SMP are the carrying costs (return and depreciation), which are not volatile in amount, such that traditional test year ratemaking cannot reasonably quantify and account for such costs. As noted by AG/CUB witness Brosch, Rider SMP is designed to account for modest and gradually increasing carrying costs associated with a multi-year program of planned technology investment. AG/CUB Ex. 1.0 at 33. These costs do not fluctuate from month to month, but are instead expected to slowly and gradually ramp up as planned capital investments are made. ComEd Ex. 43.1, 2.

The AG states that to date, ComEd has successfully modernized its network and, generally speaking, maintained reliability over the years, without benefit of an automatic rider recovery mechanism for distribution system modernization projects. ComEd witnesses assert that it has been investing hundreds of millions of dollars in new plant every year in the normal course of business. Tr. at 444.

ComEd witness Mitchell admitted that what ComEd seeks through its Rider SMP proposal is assurance of recovery of prudently incurred costs. Tr. at 95. He went on to disclose that Rider SMP ". . . wouldn't change really anything with respect to how we finance projects" because the Company would continue to use internally generated funds and issue debt. Tr. at 80-81. Thus, the AG claims that Rider SMP is not about ComEd needing extra money to finance the proposed investments. The AG also points

to financial evidence presented by ComEd as part of its Part 285 filing in this case as proof that extraordinary rider treatment is not needed to finance new plant investment. For example, a review of ComEd's historical Comparative Financial Data on Schedule D-7 reveals persistently positive Operating Income and sufficient cash flow captioned "Total Funds from Operations" from 2002 through 2006 at levels that have allowed ComEd to finance most or all of its "Gross Construction Expenditures" with internally generated Net Cash Flows. *See* Schedule D-7 at lines 9, 39, 59 and 61.

The AG points to evidence that shows that ComEd can still invest in smart grid technologies if it deems the investment worthwhile and cost-efficient. ComEd witness Mitchell admitted that the Company would return to its normal capital budgeting process to determine when and if it will invest in AMI, applying "the same kinds of standards that we always would" if the Commission denied Rider SMP, just as it would with the other proposed Rider SMP projects. Tr. at 74-76. He also stated that AMI technology could be implemented in different phases but did not specify a specific timeline. Tr. at 76-77.

The AG claims that Rider SMP is an inappropriate attempt to shift risks traditionally borne by the shareholders onto ratepayers. Moreover, the AG asserts that ratepayers will be denied most of the payback associated with the cost savings to be achieved by the investments while nevertheless incurring monthly SMP surcharges. The AG believes that the "partnership" that is said to "enable ComEd" to invest more rapidly and aggressively in optional technologically advanced features is little more than an invitation for regulators to commit ratepayers' funds in advance, eliminating any risk to shareholders that the pre-approved amounts invested will ever be found excessive, unreasonable or imprudent. AG/CUB Ex. 1.0 at 36.

Mr. Brosch points out that the utility has always maintained the management expertise, in-depth technical information, financial resources and clear responsibility to make optimized capital investment and technology deployment decisions. Based on this, the AG asserts that it is unreasonable and improper to excuse management from this responsibility by merely presenting proposed project information to the Commission and its Staff as part of an SMP approval process.

Moreover, ComEd has insisted that it would decide under its proposal exactly what it will propose for Rider SMP treatment, regardless of what was recommended or debated in any Rider SMP workshop. Additionally, during cross-examination, ComEd pointed out that the decision as to what would be proposed at the end of the formal six-month docketed proceedings would remain with the Company, and that ComEd would not wait for any kind of consensus before presenting a Rider SMP project proposal after the proposed six-month workshop process. Tr. at 430, 1042.

The AG states that while technological innovations generally can provide customer benefits, the benefits must be weighted against the cost of making the investment, and the requirement that utility rates be least cost. See 220 ILCS 5/1-102, 1-102(a), and 8-401. The Company has stated that it has conducted no marketing studies to gauge customer interest in the advanced metering services that would be provided by AMI technology. Tr. at 166-167. Without such information about customer interest in the information and services supplied by AMI technology, the AG states that it is difficult to offer reliable conclusions about discrete customer benefits.

ComEd asserts that one of the benefits associated with investment in capital projects proposed for Rider SMP treatment is the significant O&M savings that are expected to occur as a result of the investment. ComEd estimates annual potential savings associated with full deployment of AMI investment of about $73.5 million. ComEd Ex. 23.0 at 14. These savings from full deployment of AMI investment are generated from several sources, according to ComEd. See Tr. 208-216.

ComEd also estimates that it could avoid another $24.4 million in purchased energy costs associated with AMI detection of meter tampering, translating into additional O&M savings of about $6.1 million and create potential un-metered energy cost savings of $8.6 million as a result of increases in billed energy usage due to increased accuracy of solid-state meters vs. current electromechanical meters, as well as the elimination of stuck meters with the new solid-state AMI meters. Tr. at 217-218, ComEd Ex. 23.0 at 17.

ComEd witness Clair also listed 10 types of “system benefits”, which may result in O&M savings that would result from AMI deployment. ComEd Ex. 23.0 (Clair) at 18-23. These, she stated, are additional benefits that the Company has not yet quantified. Tr. at 218. Moreover, the Company estimates an additional $10.4 million in savings would occur solely during the AMI implementation period. Tr. at 214-215. Ms. Clair added that a more certain level of savings amounts could not be calculated until Phase 0 of AMI investment is conducted. Tr. at 211. She also stated that Phase 0 might identify additional costs and benefits. Tr. at 220-221. Mr. Williams testified that when an investment in the distribution system is effective at reducing restoration times, avoidance of maintenance costs associated with ComEd’s field personnel is achieved. Tr. at 698-699.

The AG takes issue with the fact that the proposed Rider SMP tariff fails to offset or reduce surcharges generated by Rider SMP projects with achieved O&M savings related to the investment, leaving Rider SMP hopelessly piecemeal and one-sided. Thus, the AG argues that Rider SMP’s design will guarantee customers are overcharged between rate cases through monthly rider surcharges because they will pay the full carrying costs (return of and on) the new SMP investments while O&M expense savings are retained by investors. This, the AG states, is patently unfair and constitutes another violation of the Act’s prohibition against single-issue ratemaking. *Id.*

AG/CUB witness Effron argues that the Company’s proposal to create a regulatory asset (ComEd Ex. 25.0 at 77-80) and reflect recovery via amortization in Rider SMP does not address in any way the income tax impacts of abandoning these existing meters. AG/CUB Ex. 4.0 at 21. A comparison conducted by Mr. Effron of the project capital expenditures associated with AMI deployment reveals that AMI outlays will be concentrated in the 2010-2013 time frame, according to ComEd’s Rebuttal workpapers. AG/CUB Ex. 4.0 at 22. ComEd’s workpapers show anticipated costs savings and revenue gains associated with that investment ramping quickly after the concentration of spending in the early years. The AG argues that this significant jump in anticipated O&M savings and revenue gains indicates a serious deficiency in Rider SMP charging ratepayers for the increasing capital expenditures, while leaving the O&M savings for the benefit of shareholders. *Id.*

The AG notes that traditional regulation is better than the flawed Rider SMP process because all of the Company's rate base investments, expenses and revenues are subject to review, forcing the Company to account for all changes in O&M that occurred as a result of new capital investment. AG/CUB Ex. 1.0 at 24. ComEd witness Donnelly concurred during cross-examination that traditional regulation and test year data will reflect realized O&M savings at the same time new investment is included in rate base. Tr. at 447-449.

ComEd currently is responsible for prioritizing and optimizing capital investment decisions. Tr. at 90. ComEd's existing capital budget process has enabled it to prudently and efficiently invest in new technology that increased the reliability of the delivery system and offered new and innovative services without extraordinary rider recovery of the financing of those investments. AG Cross Ex. 4 details the process and its many layers of approval required within the Company and its Board of Directors before discrete projects are approved. ComEd's Senior Vice President of Operations, George Williams, stated ComEd's capital additions process requires large capital investments to follow extensive approval procedures to ensure technical justification and economic optimization. ComEd Ex. 4.0 at 52. ComEd's budget process begins in March and it takes nearly a year to complete. Tr. at 91.

The AG argues that ComEd's proposed Rider SMP projects were not and would not be subject to the Company's extensive, self-correcting budgeting process that, according to ComEd's own witnesses, ensures that only prudent investment decisions are made. Tr. at 94, 203-204, 205.

ComEd withdrew its specific Rider SMP project proposals in this docket and the AG states that the Commission is left with the task of determining whether to approve a rider based on ComEd's discussion of what might be. This lack of specific information is important to the AG. A reason why Rider SMP should not be approved, according to the AG, is the lack of specific information about the costs and benefits of Rider SMP projects referenced in the case.

ComEd witness Clair testified that AMI is composed of three components: the meters and associated communication network, the meter data management system, and the integration into other ComEd Information Technology ("IT") systems. ComEd Ex. 23.0 at 8. The $600 million to more than $1 billion AMI costs estimate listed in Clair's rebuttal testimony, however, only included that first component of AMI – meters and associated communication network. Tr. at 200. Neither the meter data management system nor the integration into other ComEd IT systems components are included in this AMI cost estimate obtained from the latest RFI. Tr. at 200-201. In an updated capital budget provided in ComEd Ex. 43.1 at 1, the Company lists the cost of AMI technology investment from 2008 through 2013 to be $891,560,000. Clair confirmed that the Company could, in no way, guarantee that that amount would not change. Tr. at 198, 207-208. She states that ratepayers would be charged a return of and on the investment made in Phase 0 before there was a determination that Phase 0 had been successful. Tr. at 204.

The AG claims that the alleged benefits of AMI technology are an even more amorphous basis for approving Rider SMP. ComEd conducted no market research

studies to gauge customer interest in the services that would be provided by AMI. Tr. at 78-79. ComEd consultant and witness Stephen George presented estimates of the potential demand response benefits that could be obtained if ComEd is allowed to deploy AMI and he testified that he did not survey any ComEd bundled or unbundled customers for purposes of any of his conclusions in his testimony. ComEd Ex. 31.0 at 1; Tr. at 166-167.

Despite the lack of market research, ComEd is requesting RFIs that incorporate AMI components and add expense to a bid. Typical smart grid components include a service or services known as “Home Area Network” (“HAN”), which according to ComEd witness Clair, is technology that enables devices within the house, such as appliances, to provide more electricity usage details. This capability would be built into AMI infrastructure and presumably offered as a service to interested ratepayers upon charging ratepayers up front through Rider SMP for AMI investment. Tr. at 190. However, such a service requires customer investment in new appliances that specifically have that capability to indicate usage. Tr. at 191. Mr. Clair confirmed that the smaller the incremental time reading, e.g. 15-minute readings vs. one-hour detail, also adds cost to the technology. Tr. at 193-194. ComEd performed no market demand study to determine whether customers are interested in the HAN aspect of AMI technology, but in the RFI submitted to vendors, the requested presence of a HAN chip that provides the HAN capability increases AMI costs, anywhere from $16 to $60 million, depending on which technology is chosen. Tr. at 208-209; AG/CUB Ex. 4.0 at 20. The AG questions the propriety of charging all retail ratepayers for services that only segments of particular customer classes may use.

The record evidence also shows that Alternative Retail Electric Suppliers (“ARES”), such as CNE and others seeking to compete in the Chicago area, would gain competitive benefits upon the installation of AMI. ComEd witness Clair confirmed ARES would stand to reap many benefits with the investment in certain Rider SMP projects. ComEd Ex. 23.0 at 20. ARES would also benefit generally from the increased information offerings that come from AMI technology. Tr. at 210. The AG alleges that these facts raise issues of cross-subsidization of potentially competitive services by ComEd’s delivery service ratepayers that need to be considered by the Commission before approving a vehicle for automatic monthly rate adjustments to finance SMP investment via Rider SMP.

The CNE testimony also suggests that ComEd stands to collect additional revenues associated with AMI investment that would not be deducted from any Rider SMP surcharges, raising single-issue ratemaking concerns because new revenues might offset the alleged need for SMP surcharges, which can be prevented by incorporating plant investment into rates at the time of a rate case and under the dictates of Section 9-211 of the Act.

Other issues that the AG argues require rejection of Rider SMP are that it would require the Commission to approve Rider SMP based on assumed interest in AMI technology, before anyone has even developed evaluation criteria to determine whether Phase 0 has been successful. ComEd’s proposed Rider SMP process would have the

Commission making a determination on initial AMI investment by November 1, 2009, with ComEd then seeking approval for full deployment of AMI. ComEd Ex. 23.0 at 7.

The AG points to the lack of information regarding customer demand for new AMI-based services and the potential for new revenues and states that the only evidence of customer interest in the kinds of information services AMI would provide is underwhelming at best. Additionally, the AG points to the fact that the number of participants in the Company's residential Real-Time Pricing program, which has been offered since 2003, is only 4,902 active participants out of a total of 3.4 million ComEd residential customers for whom this service is available. Tr. at 711; ComEd Ex. 4.0 at 6.

The AG argues that the Company's traditional capital budget process and traditional rate case regulation has worked well to ensure that ComEd continues to invest in innovative technology in a prudent and reasonable manner. ComEd witness Williams describes the Company's deployment of SCADA technology, "smart" switches and mobile dispatch systems to improve service and reduce expenses. ComEd Ex. 4.0, at 14-16. Similarly, ComEd witness Mitchell describes the Company's use of aerial spacer cable, dielectric injection treatment of underground cables and other new technologies to improve distribution system performance. ComEd Ex. 1.0 at 7-8. The AG concludes that if ComEd decides that the benefits reasonably expected from smart grid or other new technologies, in the form of improved service quality and/or reduced O&M expenses, are likely to exceed the costs of the technology investment, there is no reason to believe that ComEd would not choose to invest in the technology, albeit at a pace that might be slower than presented by the Company in this docket, or that such investment would not be fully recoverable in future rate cases.

Another problem that the AG identifies with ComEd's proposal is that it would allow ComEd to seek and obtain approval of ordinary capital investment costs with Rider SMP. Under ComEd's proposed Rider SMP tariff, any project that "provides improved monitoring or performance of the Company's distribution system" is eligible for Rider SMP treatment. ComEd Ex. 30.1, Sheet 626, Item 5; Tr. at 1044-1045. The AG argues that under this broad standard, any capital investment for which ComEd seeks rate base recovery in this case falls under that category. For example, the AG states that during cross-examination, every project for which Mr. Williams testified was prudent and reasonably incurred for purposes of rate base inclusion fell into the "provides improved performance of the Company's distribution system." Tr. at 699-716.

Based on recommendations from Staff witness Hathhorn, the Company revised its Rider SMP proposal to adopt provisions similar to Part 656, the Commission's rule codifying Section 9-220.2 of the Act. Part 656 provides for rider treatment of certain water and sewer plant investments. 83 Ill. Admin. Code Part 656 AG Cross Ex. 15. The provisions incorporated into the ComEd SMP proposal include capping SMP surcharges at 5% of ComEd revenues, adding a reconciliation filing that would examine the "reasonableness" of SMP costs, and incorporating an earnings test that might generate refunds of Rider SMP surcharges. ComEd witness Crumrine cites the reference to Part 656 as one reason why the Company should not be required to reflect cost savings associated with SMP investment in the Rider SMP tariff, because "such requirements are not reflected in Part 656. The AG strongly suggests that reference to

Part 656 is an inappropriate model for proposed system modernization investment rider recovery.

AG/CUB witness Brosch testified that ComEd's modification to the SMP tariff, as modeled after Part 656, did not cure the many defects highlighted above of Rider SMP nor adequately protect ratepayers. He noted that the annual reconciliation proposed, adds administrative complexity and likely future controversy to the administration of Rider SMP, as set forth at Original Sheet 629.8 of the tariff. ComEd Ex. 30.1. Brosch likewise concluded that the 5% cap on Rider SMP surcharges provides ratepayers with no meaningful protection, at least in the short term. The 5% of revenues figure would cap surcharges at approximately $85 million annually. Given the projected spending levels listed in ComEd witness Crumrine's exhibits, the Company is unlikely to reach such an annual spending level until 2012, and then only if no rate cases are filed. AG/CUB Ex. 4.0 at 37.

Accordingly, the AG argues that the Company's suggestion that the modifications proposed in its rebuttal case mirroring some of the provisions of Part 656 improve the Rider SMP proposal and justify Commission approval of the rider should be rejected.

The AG argues that the proposed earnings test for Rider SMP plant surcharges do not protect ratepayers or cure the legal infirmities of Rider SMP. AG Init. Br. at 58. ComEd proposed in its rebuttal case incorporating an earnings test modeled after Part 656 that would require the Company to refund some or all of Rider SMP surcharges if it was shown that the Company's actual earnings over the past year exceeded its authorized return established in this rate case. ComEd Ex. 30.0 at 12. According to ComEd witness Crumrine, this earnings test would protect ratepayers and trigger refunds "to the extent that such revenues contributed to the realization of a rate of return above the last approved level." *Id.* Crumrine cited this earnings test as a reason why it should not be required to reflect cost savings associated with SMP investment through the rider mechanism. *Id.* at 18.

The AG states that during cross-examination of Crumrine, it became apparent that despite his assurances that ratepayers were protected by the proposal, it was clear that Mr. Crumrine had no idea how the Company's earnings would be calculated for purposes of the annual earnings test. The AG asserts that how the Company chooses to calculate its rate base and net operating income, and indeed what abnormal transactions are incorporated into the calculation of the Company's return, significantly affects how a reported return is calculated, and accordingly whether ratepayer refunds are deemed necessary and appropriate. The AG also asserts that Mr. Crumrine's testimony makes it clear that any Rider SMP annual reconciliation proceeding can generate significant controversy among Staff, the Company and Intervenors in any annual reconciliation proceeding. Tr. at 1066-1067.

ComEd witness Houtsma tried to explain the earnings test but Houtsma admitted that the proposed earnings "cap" for Rider SMP in no way capped earnings and did not refund to ratepayers all revenues that exceeded the Company's most allowed rate of return in the most recent rate order. Tr. at 1920. The maximum reduction is the amount of SMP revenues in the year being reconciled. *Id.* The earnings test fails to account for changes in market conditions that affect ComEd's cost of equity. Houtsma testified that

ComEd would always use the last approved rate of return as a benchmark for purposes of the Rider SMP earnings test. Tr. at 1929. However, if ComEd's cost of debt declines in future years as a result of improved credit metrics or refinancing of long-term debt, the earnings test calculation would not re-establish a cost of debt for purposes of the earnings calculation. Houtsma acknowledged that there can be significant swings in market conditions affecting the Company's cost of equity. Tr. at 1930. Houtsma concurred that there is a significant amount of judgment that would go into the Company's calculation of earnings and what if any non-recurring or recurring accounting items should go into ComEd's calculation of annual earnings. Tr. at 1937. She likewise admitted that no criteria or specific dollar thresholds exist that ComEd would use to identify and adjust each of the unusual or non-recurring transactions that would be recorded in future years. Tr. at 1938.

The AG urges the Commission to reject Rider SMP and open a separate docket to explore all of the unresolved issues involved in smart grid investment. AG/CUB witness Brosch maintains that before the Commission can determine whether costs associated with smart grid investments should be recovered in rates, the Commission must first consider the definition of safe, reliable, efficient distribution service and specify what must be done by the regulated business to meet established service reliability and energy efficiency objectives.

The AG states that until more specific information is supplied and analyzed by stakeholders on these issues, the Commission simply has no way of determining whether the kinds of investments being described in this case will be prudent and used and useful. The AG claims that the record evidence overwhelmingly shows that Rider SMP is neither needed for the Company to invest in new technologies nor legal. To support this argument, the AG states that granting approval of an automatic rate adjustment mechanism is particularly inappropriate given the Company's admission that the Rider SMP investments are "not necessary for the provision of safe, reliable, efficient distribution service." ComEd Ex. 18.0 at 16.

Additionally, the AG urges the Commission to reject Rider SMP because it violates Section 9-211 of the Act, which provides that the "Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers." 220 ILCS 5/9-211. The Act requires that the Commission make several critical findings regarding a utility's plant investments before the costs of new plant are included in the utility's rate base. Initially, the ICC must determine that plant investment is prudent as well as used and useful in providing utility service to the utility's customers. *Id*. Throughout the rate proceeding, the utility has the burden of proving that its investments meet these requirements.

ComEd's proposed modifications to mirror some of the provisions in Part 656 alternative Rider QIP permits surcharges for investment in these same four plant accounts does not ameliorate this legal infirmity. While Rider SMP would include a prudency review as part of the annual reconciliation of the preceding calendar year SMP surcharges, customer rates would have already increased, reflecting SMP investment prior to any prudency assessment according to the AG. The AG concluded

that Rider SMP violates the prohibitions contained in Sections 9-211 against including plant in utility rates before a Commission finding that the costs are reasonable and prudently incurred, and that the plant is used and useful in the provision of utility service.

The AG states that the Commission must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single issue ratemaking. *BPI II*, 146 Ill.2d at 195. Instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, the AG argues that ComEd's Rider SMP proposal considers changes in infrastructure investment in isolation, ignoring the totality of rate base, expense and revenue circumstances, and thereby constituting illegal single-issue ratemaking.

The AG maintains that Section 9-201 of the Act ensures that rates for utility service are set prospectively. 220 ILCS 5/ 9-201. Once the Commission establishes rates, the AG states that the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. *BPI I*, 136 Ill.2d at 209; *Citizens Utilities Co.*, 124 Ill. 2d at 207. The Company agreed to incorporate an annual reconciliation and prudency review within Rider SMP. ComEd Ex. 30.0 at 18. The AG asserts that this retroactive adjustment of rates is not unlike the review ruled illegal in *Finkl*, wherein the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudency review, calling it a violation of the rule against retroactive ratemaking. *Finkl*, 250 Ill.App.3d 317 at 329.

Rider SMP provides for expedited, piecemeal rate increases for incremental capital investment between rate case test years. The AG argues that this is in violation of the Commission's test year rules.

The AG notes that the Act makes multiple references to the mandate that utility rates be least cost. See 220 ILCS 5/1-102, 1-102(a), 8-401. Rates that are increased each month to pay for plant the Company admits is not needed to provide reliable electric delivery service are not least cost and the AG argues that approval of such rates violates the Act.

9. IIEC

IIEC argues Rider SMP capital projects should be included in ComEd's annual capital budgeting processes as they are currently and recovered through the normal ratemaking process. IIEC asserts that ComEd confirms that in the absence of Rider SMP ComEd would continue to invest in these projects and ask for appropriate rate base treatment in its next general tariff rate proceeding. ComEd Ex. 4.0 2nd Corr. at 30. IIEC argues that ComEd is attempting to shift operating risk to its customers, operating risk that is traditionally borne by the utility and adequately addressed through a traditional ratemaking proceeding. Since Rider SMP adjusts rates on the basis of only selected cost elements without taking into consideration other costs or factors that would affect the utility's overall profitability. IIEC argues SMP provides additional revenue to ComEd without the traditional Commission review to determine the prudence of the cost and revenue elements. IIEC finds the ratemaking approach represented by

Rider SMP bears a striking resemblance to past instances of "single-issue ratemaking" and thus should be avoided.

IIEC states Rider SMP also may distort or otherwise compromise the incentives for prudent and efficient utility operation built into the regulatory oversight and ratemaking process and may create an incentive for ComEd to maximize expenditures in certain investment or operating items to the extent such functions are allowed Rider SMP treatment, with its associated reduction in regulatory oversight. IIEC argues regulatory lag will no longer provide the utility an incentive to control utility costs to be more profitable to its shareholders and to diminish the need for future rate cases. Citing *Finkl*, IIEC argues the Court recognized that "riders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses." *Id*. at 317, 327. IIEC says the long-term, planned system improvements ComEd describes are the most expected, least unpredictable and most controllable of utility costs. They should receive comprehensive review and approval, not truncated examination and pre-approval under a rider.

IIEC asserts Rider SMP will potentially create cross-subsidies. While IIEC acknowledges that ComEd's modification of the Rider recovery mechanism away from an equal-cents-per-kWh charge is an improvement over the previous version of the rider, IIEC believes it will not fully eliminate the potential for cross-subsidies under Rider SMP. IIEC points out many large industrial customers already have relatively advanced metering installations, (a possible SMP) whether provided by ComEd, their own investments, or through a retail electric supplier and claims Rider SMP does not incorporate any allocation method that would allocate costs to those who receive the direct benefit of the Rider SMP investment and thus, there will be cost subsidies in favor of those customers that do directly benefit.

IIEC asserts Rider SMP has its own unique problems. First, IIEC argues smart grid technologies are not needed to meet ComEd's service obligations, , SMP projects are not necessary to provide delivery services in a safe, adequate, and reliable manner and that continuing to provide service with its current facilities and technology is reasonable. IIEC points out ComEd stated it would continue to invest in smart grid type projects, on the same basis it now uses for initiating construction projects, asking for rate base treatment in its next general rate proceeding. ComEd Ex. 4.0 2nd Corr. at 30.

Second, Rider SMP is so broadly defined that almost any project plausibly characterized as improving ComEd system or operating efficiency could be eligible for SMP consideration. IIEC argues these projects may far exceed ComEd's obligation to provide safe, adequate and reliable service as traditionally defined.

Third, IIEC raises the concern that Rider SMP projects could allow ComEd to provide new services on a competitive basis. IIEC acknowledges it is not clear exactly what functionalities ultimately will be available through the "Smart Grid" and other advanced technologies that ComEd outlined in its testimony, but finds it is conceivable that this type of system will allow ComEd to provide services that extend well beyond those associated with electric delivery service. IIEC argues Rider SMP projects may provide business opportunities for ComEd, or an unregulated affiliate, to provide value added services related to data management, energy facilities management, or even

voice or data communications while these opportunities and services are being underwritten through regulated rates.

Also, IIEC is concerned that many of the potential SMP projects described by ComEd may have nothing to do with delivery service. In particular, IIEC identifies SMP projects that have been labeled "technologies that facilitate demand response" as not falling within the scope of delivery services as defined in the Act, as the technologies have much more to do with generation of power, the reliability of the generation system, and the cost of generated power, than they have to do with delivery service. IIEC agrees demand response is important, but states ComEd does not need demand response for its distribution system to function. IIEC argues some of the new technologies discussed by ComEd, demand response as a particular example, are not related to delivery service as currently defined.

In response to the claims of other parties, IIEC asserts that the big supporters of Rider SMP, aside from ComEd, are primarily Retail Electric Suppliers, entities for which Rider SMP charges are not their main interests. IIEC says BOMA is an exception, offering conditional support. For RESs, the major interest in SMP projects is the potential for expanding their market opportunities, through the expenditures of Rider SMP surcharges collected from ratepayers. IIEC states most customers, however, have concluded that the proposed orders would violate one or more legal strictures, be bad policy, and distort the regulatory process.

IIEC claims the proposed Rider SMP proceedings schedule sets up a continuous process of workshops, filing reviews, and reconciliation proceedings that would challenge the resources of any non-utility party, including Staff. With Rider SMP approval, the resulting multiple tracks of biennial SMP filings and cases, annual SMP reconciliations, periodic Rider SEA proceedings, and (according to ComEd) more frequent general rate cases could price ratepayers out of meaningful participation in many proceedings affecting their rates. The theoretical opportunity for stakeholder participation in Rider SMP proceedings that ComEd touts will likely be illusory and could compromise participation in other Commission proceedings. According to IIEC, ComEd can file rate cases as often as necessary to modernize the grid. IIEC says ComEd has completed past periods of modernization investment without special cost riders, and it continues those activities today. IIEC claims that as in the past, ComEd need only prove its case under the bright lights of a rate case, not in the shadows of constrained ancillary proceedings.

10. CUB

CUB claims that Illinois courts have addressed the circumstances under which a utility may lawfully collect its jurisdictional, authorized costs outside the traditional regulatory scheme in riders. CUB states that in *Citizens Utilities Co. v. Ill. Comm. Comm'n*, 124 Ill.2d 195 (1988) ("Citizens Utility"), the Illinois Supreme Court described the process by which the Commission sets a utility's rates. CUB asserts that the Supreme Court explained that in establishing the rates that a public utility is to charge its customers, the Commission bases the determination on the company's operating costs, rate base, and allowed rate of return. CUB contends that a public utility is entitled to recover in its rates certain operating costs. CUB states that a public utility is also

entitled to earn a return on its rate base, or the amount of its invested capital; the return is the product of the allowed rate of return and rate base. CUB argues that the sum of those amounts, operating costs and return on rate base, is known as the company's revenue requirement.

CUB argues that, except in special circumstances, allowing a utility to recover a particular cost in isolation without considering the entire and panoply of costs and expenses violates the rule against single-issue ratemaking.

CUB recognizes that the exception permitting recovery of costs outside of the traditional rate-setting process is recovery through riders. CUB argues that riders allow a utility to collect revenues associated with a particular cost as it is incurred, without waiting until it files a general rate case to recover such expenses. In other words, CUB asserts that rider cost recovery allows utilities to collect a cost in isolation without "consider[ing] all aspects of the utility's operations during a year selected by the utility as a test year." *A. Finkl*, 250 Ill. App. 3d at 325.

However, CUB recognizes that rider recovery is permitted only under certain well-defined and very limited circumstances. CUB states that in *A. Finkl*, the appellate court stated that riders are permissible where the costs in question are "unexpected, volatile or fluctuating," and beyond the control of the utility. *Id*. at 327. CUB states that the Illinois Supreme Court ruled in accordance with the *Finkl* court's holding in *Citizens Utility Board v. Ill. Comm. Comm'n*., 166 Ill. 2d 111 (1995) ("*CUB*").

CUB argues that both Rider SEA and SMP fail to meet the legal criteria for rider approval established in the *Finkl* and *CUB* cases and should be rejected outright on purely legal grounds. However, CUB recognizes that there are also important policy considerations that also support rejection of Riders SEA and SMP.

CUB affirms that in addition to violating Illinois law prohibiting single issue ratemaking, Rider SMP suffers from several infirmities that fail to satisfy the necessary policy criteria required for rider recovery. CUB avers the language in Rider SMP does not ensure that eligible costs are limited to true smart grid investments. CUB witness Cohen argues that, if Rider SMP was adopted, the Company would want all of its capital investment included under Rider SMP.

Additionally, CUB declares that although the Commission would have approval authority under the Company's proposed Rider SMP, only ComEd would be able to propose smart grid projects. CUB argues that this is problematic for several reasons. First, CUB states that instead of working with stakeholders and the Commission to develop a shared vision at the outset, the Company reserves the right to design its own piecemeal approach and bring it to the Commission as it sees fit. CUB affirms that the Company would decide on its own what technology to propose for deployment, where to deploy it, and on what timetable. Second, CUB asserts that, as Mr. Cohen explained, "ComEd's financial interests and obligations may cause it to choose an investment strategy which is sub-optimal for its customers and does not provide the benefits of a true smart grid." CUB Ex. 3.0 at 7. CUB maintains that investments that the Company would find most advantageous to propose for recovery under Rider SMP would be those that could be used to generate cost savings for the Company without reducing

revenues, thereby increasing earnings through both a return on investment provided for in the rider and lower operating expenses that have not yet been addressed in a rate case. *Id*. at 8. Third, CUB argues that some inherent conflict of interest exists for ComEd by virtue of its affiliation with Exelon and its concomitant fiduciary duty to its shareholders and the possibility that smart grid technologies would reduce demand for electricity. Finally, CUB asserts that upon approval by the Commission, costs ComEd deems eligible under Rider SMP would immediately be put into rates, while the prudence of the investments remains presumed until a subsequent prudence review proceeding. CUB claims that there would be no offset to the rider for any operational or other savings incurred by the Company due to the projects. Therefore, CUB argues that though customers would pay for these investments immediately upon deployment, they must wait until the completion of the next rate case to realize any of the cost savings realized by those investments.

CUB contends that if smart grid investments are in the best interest of customers, and its benefits outweigh its costs, then the decision to deploy these technologies should not be solely within the control of the Company. CUB maintains that the Company should not be allowed to unilaterally determine the nature and scope of smart grid investments, while customers assume the risk before such investments are determined to be prudent, used and useful. CUB declares that any savings that will result from these investments should be passed through to customers as they are realized.

In its rebuttal case, ComEd agreed to modifications to Rider SMP, which are based in large part on the administrative rule governing certain infrastructure investments by water utilities (Rider QIP), 83 Ill. Admin. Code Part 656. CUB argues that these modifications do not cure the legal hurdles inherent in the rider, argued above, and do not satisfy CUB's policy concerns. CUB states that for example, Mr. Cohen and Mr. Brosch agree that the earnings cap is unworkable and would allow the Company to retain savings enabled by SMP investments instead of passing them through to customers. CUB Ex. 6.0 at 3; AG/CUB Ex. 4.0 at 36. Further, CUB asserts that the modifications do nothing to improve the conceptual and mechanical problems with Rider SMP identified by Mr. Brosch. AG/CUB Ex. 4.0 at 36. CUB recognizes that the annual reconciliation proceedings would add considerable complexity and administrative burden to an already complex regulatory mechanism. *Id*. at 37. CUB states that beyond not recognizing O&M cost savings from enhanced grid performance and reliability, Rider SMP does not recognize any of the additional revenues or the income tax benefits arising from the write-off of existing meter investments. *Id*. at 39.

CUB asserts that CUB witness Cohen, though not opposed to implementation of a true smart grid where the benefits outweigh the costs, takes issue with the propriety of rider treatment for the Company's proposed investment projects under Rider SMP, and recommends that the Commission reject Rider SMP. Instead, CUB argues that Mr. Cohen recommends that the Commission "consider the potential benefits as well as the costs of a true smart grid in a separate Commission and stakeholder-driven process." CUB Ex. 3.0 at 3. CUB claims that the stakeholder process should be led by an independent expert facilitator with experience in similar processes elsewhere, who

could assimilate the latest technical information and regulatory policy from around the country in a highly specialized and rapidly evolving field. *Id.* at 11. CUB contends that a high level of experience with similar processes will enable the facilitator to set the agenda, manage the flow of information, and focus the collaborative on timely achievement of its goals. *Id.* CUB recommends that the collaborative stakeholder process accomplish the following:

- Define the intended functionalities and properties of a true smart grid;
- Delineate principles to govern smart grid design and operation;
- Analyze the costs, benefits, and other implications of smart grid technology, and the business and use cases for its deployment;
- Identify regulatory policies, rules, and statutory provisions that would be affected by smart grid implementation;
- Incorporate utility-specific system design and engineering processes;
- Address other issues that may be identified by stakeholders.

CUB avers that Mr. Cohen further recommends that the Commission set a schedule for the work of the collaborative and the issuance of a report to the Commission by the independent expert. *Id.* CUB asserts that such a report could detail areas of agreement, recommend standards and policies, and summarize any remaining issues of contention. *Id.* CUB argues that the Commission would then use the report to order a strategic plan for smart grid deployment. *Id.*

CUB asserts that CUB witnesses Cohen and Kiesling both testify about the vast potential benefits of a true smart grid, but also caution that such benefits will only be realized if the Commission approaches smart grid planning strategically, and with ratepayers' best interests in mind. CUB argues that Mr. Cohen testifies that a true smart grid has the potential to facilitate optimal procurement planning as well as other system benefits. CUB Ex. 3.0 at 11-12. CUB states that smart grid technologies integrate electric generation, delivery, and consumption systems with communication systems to improve system function and reliability and also potentially to provide a variety of electricity products and services to the diverse range of customers in the electricity network. CUB Ex. 2.0 at 5-6. Further, CUB asserts that smart grid holds the potential to reduce operating and maintenance costs while improving reliability, as well as to reduce the cost of long-run generation, transmission, and distribution investments by reducing peak load. *Id.* at 21.

CUB contends that Ms. Kiesling lays out the necessary foundations for any smart grid planning process and advises that this Commission should approach smart grid investment from a proactive and strategic policy framework stand point, rather than the reactive approach. See CUB Ex. 2.0. CUB witness Ms. Kiesling explains why a utility-specific system engineering process is essential at the outset, the danger of premature

commitment to a particular technology, and the need to "future-proof" smart grid decision-making. Id. Ms. Kiesling identified the characteristics of a true smart grid. *See* CUB Ex. 2.0 at 6. Also, Ms. Kiesling cites the GridWise Architecture Council ("GWAC"), a group of experts formed by the U.S. Department of Energy, as the gold standard in interoperability principles and architectural frameworks to facilitate the smart grid. *Id.* at 11.

CUB argues that of the original projects proposed by ComEd for inclusion under Rider SMP, the Automatic Metering Infrastructure ("AMI") project (referred to by ComEd as Phase 0), is frequently associated with smart grid technologies. CUB states that AMI is actually only one component in a smart grid, albeit a very important one. CUB asserts that AMI is "a metering system that records customer consumption [and possibly other parameters] hourly or more frequently and that provides for daily or more frequent transmittal of measurements over a communication network to a central collection point." CUB Ex. 2.0 at 8, *citing* FERC at 17) (2006). However, CUB claims that Ms. Kiesling warns that the AMI network may be inadequate for more sophisticated, and potentially more valuable, applications of smart grid capabilities. CUB Ex. 2.0 at 8. CUB argues that she cites as examples distribution automation, plug-in hybrid vehicle interconnection and management, microgrids, demand response, and retail markets with automated customer response to real-time price signals. *Id.*

CUB asserts that the collaborative process recommended by Mr. Cohen and Ms. Kiesling would address foundational policies, as well as incorporate utility-specific issues. *See* CUB Ex. 6.0 at 6-7. CUB argues that a critical input into the collaborative process would be information derived through internal utility design and engineering exercises using established national models, and tools to identify functionality requirements and technical standards. CUB asserts that Ms. Kiesling further testifies that the development of a long-term smart grid strategy should include an implementation management process, facilitated by an independent third-party technical expert, who welcomes the participation of parties beyond the utility, develops specific functionality requirements, and incorporates industry-supported interoperability standards and other architecture standards. CUB 2.0 at 3.

CUB argues that in order to ensure sufficient interoperability, which in turn enables information sharing, enhances the reliability and effectiveness of operational and commercial functions, and a host of additional system benefits, numerous Interoperability Principles must be present in any smart grid plan (as reflected in the *GWAC Constitution Statements of Principle*). *See* CUB Ex. 2.0 at 15-16.

CUB argues that Rider SMP is incomplete and does not require the interoperability needed to ensure that these benefits are achieved. CUB asserts that ComEd's current proposal includes only four criteria for smart grid investments, instead of the more comprehensive criteria listed above and discussed in more detail by Ms. Kiesling. CUB recognizes that these criteria are necessary to ensure that smart grid investments are fully beneficial to ComEd, customers, and the electric grid. *Id.* at 16.

CUB maintains that the Company appears to agree – at least in principle – with Mr. Cohen's general recommendations with regard to the importance of a stakeholder process, and does not oppose the use of a third-party facilitator. ComEd Ex. 43.0 at 12.

However, CUB argues that the last iteration of ComEd's proposal removes all previously proposed projects from the rider, except for Phase 0 implementation of AMI. *Id.* at 4, 15. CUB contends that like its prior attempts to make Rider SMP more acceptable on legal or policy grounds, this so-called "empty rider" fails to alleviate the fundamental infirmities with the recovery of base rate investments in piecemeal rate tracking riders. CUB states that though CUB does not oppose the implementation of Phase 0 as a pilot program, it cannot be conditioned on the approval of Rider SMP, as Rider SMP violates legal and policy grounds for all the reasons articulated herein.

In sum, CUB argues that the Company has failed to show that Rider SMP is necessary. CUB asserts that based on the criteria established in Illinois Supreme Court and appellate court cases, the costs ComEd seeks to recover through Rider SMP do not rise to the level in amount or volatility of those the Court has deemed worthy of rider treatment, and would likely cause ratepayers to pay higher rates, resulting in significant additional revenues for the Company. Accordingly, CUB recommends that the Commission reject Rider SMP, and instead initiate a comprehensive, statewide, collaborative stakeholder process to articulate a strategic plan for smart grid deployment, using a third-party facilitator. CUB asserts that only then can the Commission be assured that the benefits of any smart grid technology outweigh the costs to ratepayers, and that Illinois ratepayers enjoy the smartest – and most cost-effective - grid possible going forward.

11. REACT

REACT argues that Rider SMP is open-ended, unnecessary, confusing, procedurally inappropriate and burdensome, and potentially anti-competitive. REACT also highlights that Rider SMP poses particular issues for over-10 MW customers. REACT observes that many over-10 MW customers previously invested their own money in the very type of advanced technology that ComEd now seeks guaranteed before-the-fact recovery of costs.

REACT has identified the following specific problems with Rider SMP as it relates to over-10 MW customers: 1) Rider SMP fails to account for prior investment made by ComEd's over-10 MW customers; 2) Rider SMP provides no credit for the system-wide benefits that all customers have received from the over-10 MW customers' previous investment in advanced meter technology; and 3) ComEd's assertions regarding alleged Rider SMP "benefits" to over-10 MW customers is unpersuasive.

REACT argues that these issues, like the competitive market issues that REACT states ComEd has ignored, were the subject of pre-filed testimony and extensive cross-examination at the evidentiary hearings. See generally REACT Ex. 4.0 at 8-16; REACT Ex. 5.0 at 16, 21; Tr. at 263-267, 271. Thus, REACT argues that the Commission should not allow ComEd's failure to address this issue in the initial briefing round (See Autotech Tech., 235 F.R.D. at 437) because such a failure constitutes a waiver of any objection to REACT's position. *See In re Meyer*, 197 B.R. at 280.

12. Metra

Metra notes that when ComEd initially proposed Rider SMP, the Rider included a very broad definition of eligible projects that would be included in the first group of projects funded under Rider SMP, but that ComEd has now withdrawn all of the proposed projects from consideration in this proceeding. When ComEd deleted the projects from Rider SMP, however, it declined to revise the definition of eligible projects which had been roundly criticized by the parties. Hence, the projects that are eligible for funding under Rider SMP are defined to include any capital improvement project that ComEd undertakes.

As originally proposed, the costs of Rider SMP projects would have been imposed on kilowatt hour usage, pending adjustment of future costs in the next rate case. ComEd replaced that cost assessment methodology with a very complicated formula that appears to be primarily demand based, but is so complicated it is almost indecipherable. *See* ComEd Corr. Ex. 30.0 at 11:26-0 12:266 and ComEd Ex. 30.1, 1st Revised Sheet Nos. 629, 629.1 and 629.2. According to ComEd, the Rider SMP eligible costs "would be recovered through a charge based on a percentage of distribution charges, which are predominately based on demand charges in the case of large non-residential customers." ComEd Init. Br. at 79.

The testimony in this case demonstrates that the original "Smart Grid" projects proposed by ComEd would have little or no benefit to the Railroad Class, yet ComEd projects that the average cost of the SMP project cost assessments to members of the Railroad Class will be more than four times the average cost to members of any other class. ComEd Ex. 43.1 at 2. Metra contends that wholesale disconnect between the benefits and costs of Rider SMP projects is another independent reason to reject Rider SMP.

ComEd witness Donnelly testified that the financial benefits of projected Rider SMP projects will not exceed the cost of the projects. Tr. at 557-558. At a time when all of ComEd's customers are beset with dramatically increased costs for electricity delivery and supply, Metra urges the Commission not to add to that burden by authorizing ComEd to adopt a rider given that the anticipated projects will generate more costs than financial benefits.

ComEd witness Crumrine admitted that it is entirely possible that ComEd, Staff and Intervenors could find themselves litigating at the same time a new rate case, a Rider SMP proceeding involving a proposed new set of capital projects, and reconciliation proceeding relating to prior SMP projects. Tr. at 1078:6-14. While ComEd's legal and other costs can be recovered because they are eligible for inclusion in the base rates, other parties do not have that luxury. It simply will not be feasible or possible for some Intervenors to participate in the multiplicity of proceedings envisioned by Rider SMP.

Metra contends that Rider SMP is an ill-conceived and unwarranted rider. If the Commission is truly interested in evaluating smart grid issues, it should study the issue and develop some smart grid standards, as suggested by Staff. If the Commission determines that smart grid projects are appropriate, it should ensure that the parties

who will reap the benefits also are responsible for the costs. Metra contends that there is no good reason for a rush to judgment, particularly given the fatal flaws in Rider SMP.

13. CTA

The CTA opposes ComEd's proposed new Rider SMP because the Commission should not approve a rider when the costs to be recovered from the rider are unknown and the potential projects are being very broadly defined. Second, there is no consensus as to what "smart grid" is and no assurance that ComEd's vision is correct. Third, the process that ComEd proposed in its surrebuttal testimony to have SMPs approved is unworkable and merely adds more costs for Intervenors to determine whether a particular project is appropriate. Fourth, the method by which the rider recovers costs from ratepayers does not properly track the benefits that will be provided to the customers receiving the improvements; instead, the costs would be borne on a billing percentage basis by customers who may not benefit but would be forced to pay a disproportionate share of the SMP costs, thereby needlessly decoupling costs with cost causation.

The CTA believes the projects that ComEd proposed—then later withdrew—did not contain the types of costs that traditionally are recovered under riders; that is, costs that are "unexpected, volatile and fluctuating" that "are more efficiently addressed through a rider." *CILCO v. Illinois Commerce Commission*, 255 Ill. App. 3d 876, 885 (1993). The CTA claims that the above are the types of costs that should be recovered through base rates as approved in a general rate case and not through a rider that ComEd intends to keep in place for the foreseeable future.

In its rebuttal testimony, ComEd eliminated requesting approval of specific projects from this Docket. Instead, the Company proposed that the Commission approve the rider then conduct a hearing to determine which projects should be included for recovery. The CTA opposes such an approach. The CTA agrees with Staff that it would be better to conduct a statewide hearing process to determine what standards should be applied for a "smart grid" and other technology improvements to the electric grid. There is simply insufficient time for ComEd customers to review the ComEd proposed SMPs, review ComEd testimony, send out data requests, file direct testimony (and potentially rebuttal testimony), conduct a hearing, file briefs, have the judges issue a proposed order, file exceptions to the proposed order and have the Commission make a decision in the May to October time frame advocated by ComEd.

The CTA believes that the SMPs are not projects that are necessary for ComEd to provide basic delivery service. ComEd admits that the SMP projects initially proposed did not pass through the Company's own internal budget process. Yet, the projects involve millions of dollars of investment to be paid by ratepayers. Approval of these multi-million dollar projects should not be done during the shortened period advocated by ComEd. The CTA believes that the Company has not demonstrated that the projects cannot be part of a general rate case nor has ComEd demonstrated that the benefits of the projects would exceed the costs. Thus, the proposal for approval of the rider followed by a shortened period to approval projects to be recovered under the rider is not appropriate for a rider.

Furthermore, the CTA believes that the installation of AMI and smart grid will have relatively minor impacts on the Railroad Class but the class will be required to pay a disproportionate share of the costs until ComEd's next general rate case. This is because the CTA will not benefit from items such as AMI that are designed to shift load based on the cost of power. The CTA's traction power requirements are driven by its customers, the passengers, when they require transportation service to and from their jobs. As a result, the CTA argues, improved information flow from ComEd to the CTA will not have any impact on the CTA's ability to respond more quickly to changes in consumption.

ComEd agrees with the CTA that there is a misallocation of costs to some customers under the Rider SMP proposal. ComEd attempts to justify this misallocation by arguing it would be "temporary" because "these costs would be rolled into rate base during the next rate case and allocated, to some extent, according to a cost of service study." Because there is no requirement that ComEd file a rate case at any particular time, the CTA believes this misallocation could continue for years. In addition, customers who wrongly paid for the SMPs would not be reimbursed or otherwise compensated for their improper payments, meaning they paid for projects for which they receive no benefits. More fundamentally, the CTA asserts, if ComEd can allocate the costs of each SMP to the proper class in a rate case, it could likewise do so when a particular SMP is approved by the Commission, thereby solving the misallocation problem created by ComEd's current proposals. ComEd has refused to consider properly allocating the SMPs in the first instance.

ComEd has withdrawn its request for specific approval of any project. ComEd wants the Commission to approve the rider now and, after it has obtained its blank check, then ComEd will tell the Commission what projects it will undertake by filing its list of projects for approval in the speed-up hearing process it proposes. The CTA believes such a proposal meets none of the items listed by the Commission in Peoples, Docket Nos. 07-0241/07-0242 (Cons.), (February 5, 2008). Thus, it is the CTA's position that Rider SMP must be rejected as being single-issue ratemaking and failing the tests set out by the Commission in Peoples.

14. CG

The Commercial Group does not support ComEd's SMP proposal as described in this case. Under the SMP, ComEd would recover $1 billion (or more) outside of the normal rate case process whereby utilities recover only their prudently incurred, used and useful utility costs. These fundamental cost recovery requirements protect ratepayers from excessive costs for facilities that are not necessary for utility service. ComEd admits that its SMP investment may not be necessary to provide standard electric service. Tr. at 230-31. Therefore, if recovery of admittedly discretionary SMP costs is to be allowed, more administrative oversight would be required to ensure that ratepayers do not overpay for utility service. However, AG/CUB and IIEC correctly point out the administrative difficulty of SMP proceedings separate from rate cases. It is expensive and cumbersome enough for Intervenors to hire consultants and attorneys for rate cases. Expecting them to do so for additional SMP rider proceedings is not

realistic. Thus, Intervenor input would effectively be eliminated from a significant portion of capital costs, costs that by their nature require more, not less, oversight.

Not only should the SMP proposal be rejected for the above-stated reasons, ComEd has withdrawn from consideration in this proceeding any specific SMP projects. Without SMP costs, approving the SMP as a cost recovery mechanism is a moot issue. This also requires rejection of the SMP proposal.

To the extent the Commission approves Rider SMP, the Commission must ensure that SMP rate design is fair. During the course of this proceeding, ComEd responded to the concerns of several customer groups and proposed a change in recovery of allowed SMP costs from an equal per KWH charge to all classes to a charge based on a percentage of a customer's bill. If underlying base rates are set at cost this would be a fair way to set an SMP charge. However, as Mr. Crumrine admitted, to the extent base rates contain an above-cost rate subsidy, the percentage of SMP charge would increase that rate subsidy burden. Tr. at 1124:16-1125:1. Therefore, the Commission should first set cost-based rates and then set a percentage bill allocation of any SMP costs.

15. Staff

Staff, in its supplemental direct and rebuttal testimony, recommend against approving Rider SMP. Staff, instead, recommends that the Commission initiate a separate process to consider AMI and smart grid topics outside of this rate proceeding rather than tie the fate of AMI and smart grid technology to a specific rider in the narrow time frame allowed by a rate proceeding. Staff Ex. 9.0 at 25. There were two reasons for Staff's recommendation. First, AMI and smart grid investments are important issues that deserve more consideration and attention than they can be given in this proceeding. Moreover, the clear direction of federal policy, as embodied in the Energy Independence Security Act of 2007 ("EISA"), Public Law 110-140, is for states to consider smart grid topics. The Commission should begin a process outside of this rate case during which the Commission can consider whether the approximately $1 billion cost of AMI and smart grid investments would be justified by the potential benefits that could be achieved by such a significant investment.

Second, Rider SMP itself, as ComEd has proposed it, suffers from various shortcomings. Rider SMP promotes a project by project approach that is not tied to any process that would give careful consideration to an overall approach that is appropriate for Illinois. This is evidenced by the fact that ComEd has already proposed specific projects to be recovered through Rider SMP before the Commission has begun its consideration of the smart grid topics listed in EISA.

In addition, Staff posits that ComEd's current proposal reflects changes to certain terms and conditions of Rider SMP that it accepted during the course of this proceeding, and a revised Rider SMP process that will include a six-month workshop process and a 6-month project review and approval proceeding before approval and implementation of specific projects. While the changes ComEd has incorporated into Rider SMP have generally improved its proposal and eliminated or reduced some of Staff's objections to

approval of Rider SMP, Staff argues that all issues were not resolved and Staff remains opposed to approval of Rider SMP at this time.

Staff also offers an alternative recommendation. If, contrary to Staff's primary recommendation, the Commission decides to approve Rider SMP in this rate case but waits to approve projects for recovery under Rider SMP until after a collaborative process to discuss the projects as proposed by CNE, then Staff argues that the Commission should adopt only a version of Rider SMP that includes the conditions Staff sets forth below.

While the bases for Staff's opposition to Rider SMP will necessarily take the form of adversarial positions in this contested proceeding, Staff's opposition is primarily driven by the fact that ComEd seeks approval of a cost recovery mechanism for an undertaking that has not yet been adequately defined or established in terms of details, scope or duration. In other words, Staff asserts that the most appropriate process to reach the best decisions about grid modernization should first determine what needs to be done, and then determine whether and to what degree it is necessary to approve a particular non-traditional, cost recovery mechanism – *i.e.*, a rider.

Staff's position is that the issue of grid modernization is simply too large and too complex to entrust its study and analysis to a process with a timeline that is rigidly constrained by a calendar. Tr. at 154. While ComEd and certain parties advocate a fixed 6-month timeline, it is Staff's view that the timeline for such an investigation should be driven by the information that is developed in the course of the investigation and that 9 months is a more appropriate estimated timeframe. Further, the parties -- or any one party – should be able to request that the Commission extend any timeline so as to preserve the ability to avoid the premature termination of the process due merely to the passage of time.

Staff submits that there is no dispute that the business case for the deployment of AMI and smart grid technology is not a strong one. Staff Ex. 20.0 at 11; ComEd Ex. 23.0 Corr. at 18; ComEd Ex. 9.0 at 6; ComEd Ex. 15.0 at 11-12. For example, ComEd's estimate of the proposed AMI investment's net benefits are positive but low (net benefits of $28 million from an investment of approximately 800 million to 1 billion dollars) and the estimated pay back period of approximately 16 years is so lengthy that ComEd calls the investment "marginal." ComEd Ex. 23.0 Corr. at 7-8, 18. Also, these kinds of projects are discretionary and do not normally fare well in the competition for Company funding. ComEd Ex. 4.0 2nd Corr. at 29-30; ComEd Ex. 15.0 at 12. Even though the business case for smart grid technology may not be strong, Staff acknowledges that the potential societal benefits of a smart grid are such that they should be pursued.

Staff asserts that another reason why the Commission should review AMI and the smart grid is the support by federal legislators that states should undertake such a review. To that end, Title XIII of EISA requires states to consider two ratemaking standards from the Public Utilities Regulatory Policy Act that concern smart grid investments and smart grid information. The more relevant of these proceedings, Section 1307 "State Consideration of Smart Grid," requires the Commission to open its consideration of the standard by December 19, 2008 and conclude its investigation by December 19, 2009. ComEd's Rider SMP proposal is premature in that it would have

the Commission approve specific projects and a specific ratemaking mechanism before the Commission has even considered the extent to which the federal standard should be applied in Illinois as the Commission is required to do under federal law.

Staff also believes that as part of its review of the smart grid and AMI, the Commission should also consider the relationship of smart grid technologies to electric service standards. The evidence in this proceeding regarding this relationship is unclear at best. ComEd acknowledges that smart grid projects are not necessary in order for ComEd to meet its service obligations. ComEd Ex. 1.0 at 11; ComEd Ex. 15.0 at 2. In fact, ComEd plainly states that it is unlikely to undertake these projects unless some special rate recovery mechanism is first put in place. ComEd Ex. 15.0 at 3, 12; ComEd Ex. 28 at 25. Staff witness Stoller explains that ComEd's responsibility is to provide a minimum level of service quality for its customers. With Rider SMP, ComEd proposes to charge customers for the cost of certain projects that are not necessary to fulfill those basic, statutorily-required service obligations. Staff Ex. 13.0 at 3.

In Staff's view, the Commission need not approach this issue in a vacuum. Clearly the Commission must base its decisions upon Illinois law, policy, and circumstances; however, Staff argues that the Commission can also draw upon the lessons learned by other state commissions regarding system modernization where the Commission finds it proper and fitting to do so. Staff witness Schlaf found that other state commissions have deliberated carefully about whether AMI investments would be appropriate for their states. Typically, these states are using a step-by step approach including workshops, rulemakings, and the filing of deployment plans and cost-benefit analyses. Staff states that the record in this proceeding points to the need to for such a process, but it does not contain the substance or results of such a process.

Staff also recommends the Commission not approve Rider SMP in this rate case because Rider SMP itself, as ComEd has proposed it, suffers from various shortcomings. According to Staff, the SMP projects ComEd has identified are far less than the amount ComEd normally spends on capital improvements from year to year. The SMP projects proposed for 2009 through 2013 are only 23% of the average amount ComEd has invested for standard or typical installations in the years 2001 through 2007. Additionally, ComEd's estimated revenue requirement for SMPs after 4 years is much less than its annual fluctuation in operating expenses between 2001 and 2006. This would indicate that the expected Rider SMP revenue requirement would fall within a reasonable range of year-to-year cost fluctuations making an additional charge under Rider SMP unnecessary. Staff Ex. 11.0 at 9-10. Moreover, had ComEd filed its rate case three months later with a 2009 future test year, its proposed SMP projects could have been included in its proposed rate base, further rendering Rider SMP unnecessary. Staff Ex. 11.0 at 8.

Another shortcoming, according to Staff, is that Rider SMP's language is vague and would permit it to be applied to a much broader range of projects than ComEd itself says it plans to propose for Rider SMP.

Staff asserts that the failure of Rider SMP to narrowly define the costs that can be recovered thereunder appears to be a fatal flaw at this time, and is not saved by the provision for Commission approval of specific projects in advance. In *City of Chicago v.*

Illinois Commerce Comm'n, 13 Ill. 2d 607, 608-609, 614 (1958) ("*City I*") – in an appeal from a Commission order approving a rider for Peoples Gas "providing for an automatic adjustment from time to time of its sales price for gas, to reflect changes in the wholesale cost to Peoples of natural gas purchased" -- the Illinois Supreme Court determined, in a case of first impression, that the Commission was authorized under the Act to approve an automatic adjustment clause in a proper case.

City I held that "notice is not required on each occasion when there is a change in ratepayers bills but that notice is required for every change in the filed schedules which are the underlying basis for the computation of these bills." *Id.* at 613-614. Staff contends that the failure of Rider SMP to specifically define the costs eligible for recovery under Rider SMP contravenes this requirement. Under Rider SMP those costs will only be defined when a project is specifically approved by the Commission, and that proceeding is a special Rider SMP proceeding rather than an Article 9 proceeding with notice to rate payers. While Staff does not oppose the approval feature of Rider SMP, that feature does not remedy the failure of Rider SMP to adequately specify the costs eligible for recovery under Rider SMP.

With respect to ComEd's assertion that a rider mechanism is the only way to achieve regulatory certainty as to the prudence of undertaking such investments before they are made, Staff asserts that ComEd is in error. Section 8-503 of the Act specifically empowers the Commission to authorize additions, extensions, repairs or improvements to utility plant if certain findings are made. Staff also notes that Section 8-503 allows the Commission to direct a utility to undertake certain investments. Rider SMP, by limiting itself to projects proposed by ComEd, conflicts with this statutory power. In the event the Commission decides to approve Rider SMP, Staff states that Rider SMP not limit in any way, including in Rider SMP approval proceedings, the Commission's authority to direct ComEd to undertake certain investments under Section 8-503.

In addition, Staff witness Linkenback is of the opinion that the standard for a prudence finding for the proposed SMP projects should be based upon standards similar to those in Section 9-212 of the Act, which he explained is the same standard the Commission uses when evaluating capital additions to rate base in a rate case proceeding. Staff Ex. 12.0 at 8. Staff witness Hathhorn also agreed to a six, rather than a nine month, approval period for SMP projects based upon the requirement that all ComEd filings for approval of SMP projects include evidence, at the time of filing, to determine the SMP projects' prudence. Staff Ex. 14.0 at 21-22. Should the Commission decide to approve Rider SMP, Staff recommends that the Commission endorse the standards set forth in Section 9-212 of the Act with regard to Rider SMP projects.

A number of Intervenors, including the AG, also oppose approval of Rider SMP. In general, Staff agrees with the technical and factual criticisms by these parties regarding ComEd's support for approval of Rider SMP. However, Staff did not make certain legal arguments regarding Rider SMP that various Intervenors raised in their initial briefs regarding single-issue ratemaking, retroactive rate making, and test year rules. Staff explains that while it believes the Commission should exercise its discretionary authority to reject Rider SMP at this time, Staff finds that ComEd's

agreement to incorporate various consumer protections into its proposed Rider SMP presents circumstances under which the Commission may have the discretion to approve Rider SMP notwithstanding the prohibitions against single-issue and retroactive ratemaking and the Commission's test year rules.

Staff observes that in the instant case, the nature of Rider SMP clearly presents some risk that rates could increase for SMP investments at the same time that savings, cost reductions or revenue increases are achieved. However, ComEd has agreed to an earnings test that significantly tempers this risk by requiring ComEd to forego recovery under Rider SMP if and to the extent its actual earnings exceed its last authorized rate of return. In this manner, Staff asserts, Rider SMP indirectly takes into account savings, cost reductions and income changes. In Staff's view, an earnings test can sufficiently address the risk of the harm to ratepayers that the prohibition against single-issue ratemaking is intended to remedy, and for that reason Staff does not assert a single-issue ratemaking argument. That is, if the Commission finds that adequate justification exists for Rider SMP, the prohibition against single-issue ratemaking would not divest the Commission of discretion to approve Rider SMP given the earnings test provision incorporated into Rider SMP. Staff is clear, however, that the presence of an earnings test would not automatically call for an exception. Rather, the facts of each case need to be examined and analyzed.

Similar to the single-issue ratemaking issue, Staff does not assert retroactive ratemaking or test year arguments as does the AG and others. With respect to retroactive ratemaking, Staff's view is that Rider SMP does not operate so as to adjust a rate which was previously approved by the Commission. For this reason, Staff does not believe retroactive ratemaking is an issue. With respect to the test year rules, Staff notes that the goal or purpose of those rules is very similar to the goal or purpose of the prohibition against single-issue ratemaking: to ensure that all costs and revenues are considered together over a uniform period. Where courts have found adequate justification for adoption of a rider, they have not found a violation of the Commission's test year rules.

For all the reasons discussed above, Staff believes a separate process is still the most appropriate approach. Tr. at 153-156. However, if the Commission, contrary to Staff's primary recommendation, believes it is appropriate in this proceeding to authorize a rider for the recovery of smart grid investments, then Staff's secondary recommendation is that the Commission should adopt only a version of Rider SMP that is conditioned on the following:

1. Rider SMP cost recovery treatment should be reserved for system technology enhancements, including smart grid and AMI projects, for example, and not be available for routine, traditional component repairs or replacements even if to do so might result in reliability enhancement.

2. The approved Rider SMP tariff should leave blank the definition of "System Modernization Projects" and the "Approval Process" section until the Commission, at the conclusion of the separate collaborative proceeding described below, determines

guidelines for classifying capital investments as System Modernization Projects that are then eligible for Rider SMP consideration and how cost recovery for those projects should occur.

3. An alternative to point #2, above, is to rewrite the definition of "System Modernization" to clearly restrict the Rider's applicability to AMI and similar smart grid projects, and not adopt the Company's broad definition of SMP as "…any project, for which there are capital investments…that the Company classifies as pertaining to the improvement of the Company's distribution system for the purposes of enhancing service provided by the Company to its retail customers…', and the "Approval Process" timeline should be revised to accommodate the outcome of the separate collaborative proceeding described below. This could be accomplished by adopting language changes based on Section 1301 of EISA to the definition of a system modernization project in Rider SMP.

4. The Rider SMP tariff should be subject to the conditions that Staff witness Dianna Hathhorn proposes in her testimony, as revised and accepted by ComEd. Staff Exs. 10.0; 14.0 at 20; ComEd Exs. 30.0 at 9-18, 43.0 Corr. at 20-24; Tr. at 663. Those conditions are: (1) a six month annual approval process so long as certain information is provided in testimony filed at the beginning of the SMP approval process; (2) the Inclusion of Projects in Rider SMP does not establish ratemaking treatment; (3) mandatory annual reconciliation proceedings including a true-up process, with no deadlines for such proceedings ComEd Ex. 30.0 at 16; (4) SMP subject to refund as part of a mandatory annual earnings test ComEd Ex. 30.0, 14:317-318; ComEd Ex. 47 Rev.; (5) mandatory annual internal audits with specific audit tests required therein ComEd Ex. 30.0, 17:379-381; (6) require that Allowance for Funds Used During Construction not be allowed to be charged to Rider SMP ComEd Ex. 30.0, 18:417-418; (7) Offset SMP Costs with Reimbursements Received related to SMP; (8) Commission approval of regulatory asset prior to inclusion in Rider SMP; and (9) creation of a regulatory asset for undepreciated meters based on the average remaining useful life of such meters.

5. ComEd can recover project costs through Rider SMP only with specific prior Commission approval of the individual projects.

6. Rider SMP should be a pilot program only, to last no longer than through December 31, 2012 for new projects. However, the cost recovery of projects previously approved under Rider SMP would continue under Rider SMP until January 1, 2015 or until a final order in ComEd's first rate case filed after December 31, 2012, whichever occurs first.

7. Rider SMP should be re-filed following the end of the collaborative workshop process described below, assuming there is complete agreement; however, in the event there is not complete agreement, Rider SMP should be filed in accordance with the Commission's determinations from the Commission proceeding resolving any contested issues from the workshop process about what projects should be eligible for Rider SMP consideration and treatment.

8. The Commission should initiate, following the conclusion of this rate case or sooner, a collaborative workshop process that will thoroughly examine the grid modernization concept and how it should be implemented. This collaborative workshop process is separate and distinct from the six-month process proposed by the Company to address its proposed individual projects for Rider SMP treatment. The collaborative workshop process should generally observe the following guidelines:

> a. The collaborative should move on an expedited basis with the goal of being completed within nine months. However, neither the Commission nor any party knows at this time just how much information parties may find it necessary to examine and analyze to make enduring recommendations to the Commission. Thus, the collaborative should be subject to Commission oversight and may last more than nine months if such an extension is approved by the Commission. Such approval, if needed and appropriate, may be sought via a Staff report to the Commission or via a motion filed in this Docket.
>
> b. After determining the appropriate technological route to follow for smart grid investments, the collaborative workshop should make a recommendation to the Commission, in the form of a Staff Report for Commission consideration, summarizing any contested and uncontested issues about how to define which projects should be eligible for Rider SMP consideration and treatment, and about the process through which projects which should be considered for Rider SMP treatment, should be proposed, evaluated and approved.
>
> c. Once the collaborative workshop is completed, and in the case of no contested issues, if the Commission adopts those recommendations of the collaborative workshop, ComEd shall re-file Rider SMP to bring it in accord with a Commission determination about its contents and begin proposing projects to the Commission for Rider SMP consideration and treatment. In the event there are any contested issues from the collaborative workshop process following a Commission proceeding making a determination on the contested issues, ComEd shall re-file Rider SMP to bring it in accord with a Commission determination about its contents and begin proposing projects to the Commission for Rider SMP consideration and treatment.

Staff concludes that the gist of its primary recommendation is that the Commission should not feel pressured to rush to judgment about the way to implement system modernization. That is, the Commission should take what ever time the Commission feels is necessary to gather and consider the information it needs in order to make a high quality decision about how Illinois electric utilities should approach and deploy smart grid technologies, including a thorough evaluation of the monetary and service quality accruing to Illinois' electric customers.

16. Commission Analysis and Conclusion

The Commission commends ComEd for its initiative in pursuing smart grid and AMI. Staff witness Schlaf described many of the operational and societal benefits of AMI, *i.e.*, reduced headcount for meter readers, fewer field visits to restore power outages, less time fielding customer complaints, minimizing future generation costs, reduced need for upgrades and investments to ComEd's transmission and distribution systems and also environmental benefits. Some of these environmental benefits are possible through reduced power plant emissions and fewer vehicles on the road.

RESA, in its Reply Brief, states that "if the AMI works as we believe it should, the result of using electricity more efficiently should help delay the need for new generation, make existing generation more efficient, and could even result in a decline in the amount of generation used per customer."

Several Intervenors suggest that ComEd's proposal is in violation of the Commission's basic service rules, but the evidence in this proceeding suggests that parties only raise this argument in the context of rider recovery of these investments. In other words, these parties do not object to these projects being included in rate base. Staff witness Linkenback stated his disapproval of rider recovery because the Company is already investing in these projects, *i.e.*, SCADA, and recovering the cost through rate base. Yet, he immediately followed this claim with a discussion of how it is inappropriate to recover these costs through Rider SMP because they go beyond basic service requirements. Staff Ex. 19.0 at 19-20. There is an inconsistency here. If ComEd should not be able to recover these costs through a rider, because they are above and beyond basic service, then the Company likewise should not be able to recover these costs through base rates. Because no party has argued against including these projects in rate base, it undermines any argument that these projects go beyond basic service requirements.

There is some argument to suggest that smart grid does not satisfy the Commission's least cost standards. Our least cost requirements, however, do not require that electric service be the most simple, basic, and cheapest form of electric service available. The least cost provisions require that the chosen electric service be provided in the least cost manner. So, for our purposes here, the least cost provisions would require that the smart grid installed be at least cost, *i.e.*, the various components must be optimized to provide maximum benefits to consumers, subject to competitive bids and the labor must be provided at competitive rates.

The Commission service rules do not contain a prohibition on investing to improve service or a bar to providing more beneficial services. Indeed, they contain minimum and not maximum requirements. A rewrite of our rules has not been shown to be necessary in order for an electric utility to recover its investment in smart grid through either base rates or a rider.

The Commission very recently analyzed the legal precedent regarding the Commission's authority to approve riders in the Peoples Gas rate case when considering proposed Rider VBA. Dockets 07-0241/07-0242 (cons.). Without restating that analysis, it is clear that we have the authority to adopt the rider mechanism in

proper situations and under circumstances that are lawful and reasonable. In fact, smart grid may be just the sort of investment that is appropriately recovered through a rider.

While the Commission has the authority to approve riders, each subject underlying situation and design require a particularized analysis. In this instance, the Commission believes that it must first determine how smart grid should be deployed in Illinois, and then determine whether and to what degree it is necessary to approve a particular cost recovery mechanism. Lacking an overall goal for Illinois, Rider SMP simply promotes a project by project approach. Further, although ComEd has agreed to a workshop process, it would still retain sole discretion in determining what projects are ultimately proposed to the Commission.

Similarly, without an overall plan for smart grid deployment and without any specific projects being proposed, the Commission does not know the extent of the costs and benefits involved, with the possible exception of Phase 0. The estimates of costs in the record have varied greatly and the estimates of benefits have been sporadic at best. This lack of cost and benefit information is a problem that is not overcome by the process proposed for Commission pre-approval of specific projects. Our hope is to have a better grasp of costs and benefits once Phase 0 is implemented and analyzed, as discussed below.

The lack of a consistent, thorough and analytic approach to estimating benefits simply highlights another shortcoming: ComEd is asking for special recovery for these projects that – whatever their level, all parties agree -- could have long-term economic benefits, but as proposed, ratepayers do not share the economic benefits. It is not clear that the earnings cap, with all its potential for disagreement, adequately answers this concern. Another concern about the process that was raised by many parties is that they would be overburdened by the workshops, pre-approval dockets, earnings cap and prudence review dockets and the real possibility of additional rate cases by ComEd.

With these concerns in mind, Rider SMP is approved, as discussed in the section below, and for the very limited purpose of implementing Phase 0 – a scaled deployment of AMI – as a pilot program. Rider SMP is also subject to the conditions that Staff witness Hathhorn proposed in her testimony, and as revised and accepted by ComEd in its surrebuttal testimony. Phase 0, however, is only the first step. A broader plan is needed to develop a policy framework and to address parties' concerns that there is no well structured plan with identified costs and benefits. To address this need ComEd, CNE, CUB, and Staff propose various collaborative processes. From these proposals, CUB seems to outline the best proposal for a statewide smart grid collaborative.

a) Phase 0

Phase 0 is primarily the installation of up to 200,000 advanced meters and associated infrastructure. There are a number of tasks that need to be completed to ensure the success of this pilot program. As discussed in more detail below, these tasks are: the formation of a workshop process ("AMI Workshops") led by an independent third-party facilitator; the development of goals, timelines, evaluation criteria, etc. in the AMI Workshop process; the docketed proceeding approving AMI

deployment and cost recovery; the installation of AMI; the monitoring of and data collection of AMI performance; and the production of reports to the Commission on the progress and results of Phase 0. In addition, all of this is to be coordinated with a Statewide Smart Grid Collaborative process, discussed below.

ComEd witness Clair testified that Phase 0 will enable the Company to quantify the costs and benefits of full AMI deployment. While the Commission understands how the proposed Phase 0 will allow ComEd to quantify the costs of a full AMI deployment, the process by which ComEd quantifies the benefits remains unclear. The AMI Workshops, described below, shall fully investigate the measure of benefits from the utility side of the meter.[1] Ms. Clair also testified that, after deployment of AMI, ComEd will be able to analyze certain aspects of AMI's performance and operation. Therefore, following the deployment of AMI and a period of analysis that is extensive enough to enable ComEd to evaluate Phase 0, ComEd is directed to prepare a report assessing the results of Phase 0. ComEd is directed to make this report available to the Commission and the Statewide Smart Grid Collaborative, which is described below, because analysis of Phase 0 is one of the issues to be addressed in the Statewide Smart Grid Collaborative. Therefore, the AMI Workshop cannot conclude until ComEd has prepared the Phase 0 evaluation report and the AMI Workshop participants have had an opportunity to review the report.

As proposed, Phase 0 of the plan for AMI deployment would be limited to roughly 200,000 customers with the expectation that meters will be installed by the end of 2009. The Commission's expectation is that the actual field testing and analysis of the Phase 0 may take an additional 12 months, though we acknowledge these timelines may be changed in future proceedings. ComEd may submit Rider SMP through a separate compliance filing so that Rider SMP for Phase 0 will be effective no later than October 1, 2008.

The Commission directs that the AMI Workshop process, as proposed by CNE witness Fein and refined in the surrebuttal testimony of ComEd witness Crumrine, begin as soon as practicable to develop project goals, timelines, evaluation criteria and Phase 0 technology selection criteria. Because the Commission is adopting Rider SMP for the limited purpose of a pilot program (Phase 0), the Commission perceives no need for the biennial filing schedule (whereby ComEd would file for approval of new projects and the continuation of existing projects every two years). If, in subsequent proceedings, the Commission decides to continue with AMI and smart grid proposals beyond Phase 0 then the need for a biennial filing schedule can be reevaluated. CNE and ComEd state that the AMI workshop process could be completed in about six months. The Commission finds that time period to be reasonable. If more time is necessary, a request for more time can be brought to the Commission.

CUB proposes, and ComEd does not object, that a third-party facilitator be employed to direct the workshop process. The Commission agrees with CUB and finds the use of a third-party facilitator to be important and appropriate. Accordingly, all

[1] Potential customer side benefits necessary to perform a cost-benefit analysis shall be analyzed in the Statewide Smart Grid Collaborative.

interested parties may submit recommendations to the Executive Director of the Illinois Commerce Commission ("Executive Director"), or his designee, for a third-party facilitator. The Executive Director, or his designee, shall then solicit the information needed to make a decision and select the candidate determined to be the most qualified third-party facilitator. The Executive Director, or his designee, shall then notify ComEd of the selected candidate. ComEd shall retain the services of that candidate as the third-party facilitator. In addition, the Commission finds it necessary to be kept apprised as to the progress of the AMI Workshops, therefore, the third-party facilitator shall report to the Commission every ninety days on the progress of the AMI Workshops.

Due to the fact that the exact scope of the Phase 0 project will be defined in the AMI workshops, the Commission is not approving a recovery of specific costs in this Order for Phase 0. In order to recover its costs through Rider SMP, ComEd must file a request for approval of the Phase 0 project after completion of the workshop process. In addition, the request will also require the Commission's approval of the goals, timelines, evaluation criteria, etc., that were developed in the workshops. At the time that ComEd requests approval of Phase 0, the Commission will address the amortization period for the meters that will be retired.

The annual reconciliation proceeding, as proposed by the Company, will examine the reasonableness of Phase 0 project costs. In this docketed proceeding, the Commission will review ComEd's earnings to determine whether Rider SMP refunds are in order (not to exceed the amount of SMP surcharges) if it is determined that the Company's reported earnings exceeded the rate of return established in this rate case.

b) Statewide Smart Grid Collaborative

The Commission recognizes that AMI deployment alone will not produce the benefits of a comprehensive digital smart grid. Furthermore, the Commission does not want – through an inadvertent sequencing of proposals, pilot projects, policy decisions and workshops – to unnecessarily delay implementation of the broader set of digital tools comprising the smart grid. And yet, at the same time, the Commission believes that smart grid deployment should not be a matter of haste. Our concern here is that under the Company's proposal we are being asked to quickly approve various improvements that resemble a smart grid, yet the Commission has insufficient information to assess if these improvements actually qualify as smart grid. Under these circumstances, if the Commission adopts Rider SMP too quickly and without sufficient stakeholder input or Staff analysis, the Commission would not be sure that consumers are the primary beneficiaries.

The potential benefits of a smart grid are such that smart grid and AMI topics should be pursued and considered by the Commission in a deliberate and thorough yet expedited manner. The clear direction of federal policy, as embodied in the EISA, is for states to consider smart grid topics. According to Staff witness Schlaf, the Commission must open proceedings to consider the two EISA smart grid ratemaking standards by December 19, 2008 and conclude its investigations by December 19, 2009. Staff Ex. 9.0 at 6. It is not clear that the EISA proceeding is the proper vehicle.

The Commission agrees with CUB, that a Statewide Smart Grid Collaborative process could adequately address the concerns expressed above. Therefore, a Statewide Smart Grid Collaborative involving the two large investor owned utilities regulated by this Commission, other stakeholders and Staff shall be initiated outside of this rate case during which the participants and the Commission can consider the costs and benefits of smart grid implementation and develop a strategic plan for such implementation for presentation – upon completion and in a docketed proceeding – to the Commission. The AMI Workshop and the Statewide Smart Grid Collaborative are to be initiated contemporaneously. While the AMI Workshop will be concluded in a relatively short period of time (six months), the Statewide Smart Grid Collaborative shall be conducted within twenty-four months of October 1, 2008. If it is determined that more time is necessary, that request can be brought to the Commission.

The purpose of the Statewide Smart Grid Collaborative is to develop a strategic plan to guide deployment of smart grid in Illinois, including goals, functionalities, timelines and analysis of costs and benefits, and to recommend policies to guide such deployment that the Commission can consider for adoption in a docketed proceeding. The analysis of benefits shall include reductions in utility costs related to maintaining and operating a distribution system as well as potential changes in consumer costs related to decreased energy consumption, reduced procurement costs, and increased price responsiveness and demand response.

We agree with CUB that the collaborative process should address foundational policies, as well as incorporate utility-specific issues. The policies that are to be considered in the Statewide Smart Grid Collaborative include, but would not be limited to: 1) definition of a smart grid and its functionalities; 2) principles Illinois should use to guide smart grid planning and deployment, for example, interoperability, open architecture, and non-discriminatory access; 3) uniform standards; 4) methods of estimating, calculating and assessing benefits and costs, including evaluation of non-quantifiable benefits (and costs); 5) implications of smart grid technology for future policies regarding rate design, consumer protection, and customer choice; 6) effect of statutory renewable resource, demand response and energy efficiency goals on smart grid planning and implementation; 7) consumer education and dissemination of information about smart grid technologies, demand response programs and alternative rate structures; 8) access by electricity market participants to smart grid functionalities; 9) data collection, storage, management, security, and availability to third parties; ~~9~~10) standards for interconnection of third party equipment; 11) mechanisms to flow through to customers any utility smart grid revenues; 12) adoption of new demand response programs; and 13) open architecture and inter-operability standards for technological connectivity to the RTO and/or ISO to which a utility may belong. CUB makes clear that many of these policy issues have been considered in national, regional and other statewide forums. To ensure efficiency in addressing the foundational policies, the Commission encourages the facilitator and attendees to incorporate this knowledge and information gained from these other processes into the Collaborative discussions, where practicable.

As the Commission directed previously, with regard to the AMI Workshops facilitator, a third-party facilitator ("Facilitator") shall also direct the Statewide Smart Grid Collaborative. Accordingly, all interested parties may submit recommendations to the Executive Director, or his designee, for a Facilitator. The Executive Director, or his designee shall then solicit the information needed to make a decision and select the candidate determined to be the most qualified Facilitator. The Executive Director, or his designee, shall then notify utility participants in the Collaborative of the selected candidate. The two utility participants shall retain the services of that candidate as the Facilitator. The Commission shall retain hiring and firing authority of the Facilitator. The Facilitator shall report to the Commission every ninety days on the progress of the Statewide Smart Grid Collaborative. At such time, the Facilitator will report any consensus items as well as any areas of disagreement. At the end of the Statewide Smart Grid Collaborative, the Facilitator shall prepare a report ("Collaborative Report"). The Collaborative Report is the product of the Statewide Smart Grid Collaborative's work and shall include a proposed smart grid vision for Illinois, summarize the foundational policy issues discussed in the Collaborative, recommend a policy framework for achieving that vision and recommend steps toward implementation. The Collaborative Report shall be publicly submitted to the Commission for consideration.

ComEd will pay its share of the expenses associated with the Statewide Smart Grid Collaborative. If applicable, the Commission may approve the use of grant money to pay the costs of the Statewide Smart Grid Collaborative. The Facilitator shall include in its ninety-day progress reports a discussion of the availability of grants and potential avenues for applying for those funds.

In its Brief on Exceptions, BOMA contends that the PO fails to recognize its concerns regarding the availability of information. The Commission finds, however, that these concerns are more appropriately addressed in the AMI Workshops and Statewide Smart Grid Collaborative.

Following the Statewide Smart Grid Collaborative, the Commission will open a smart grid proceeding ("Smart Grid Policy Docket") to consider the Collaborative Report provided by the Facilitator. In this proceeding, the Commission may adopt the policy framework developed in the Statewide Smart Grid Collaborative in whole or in part, or modify said policy framework. Any outstanding issues among the parties can also be resolved in this proceeding.

c) Smart Grid Implementation Docket

The Commission finds that the Company may re-file Rider SMP (or more appropriately Rider SG – Smart Grid) after the completion of Phase 0 and the Smart Grid Policy Docket. Renaming the rider to Smart Grid clarifies for consumers what they are paying for and also explicitly limits the rider to smart grid investments. With that filing, the Company should be prepared to explain how it will implement projects and plans consistent with the findings and policy framework for smart grid deployment approved in the Smart Grid Policy Order. ComEd shall also present the cost benefit analysis and other information that the Commission sought in the Peoples Gas proceeding (Docket 07-0241/07-0242). Among other things, the Company should show

whether the earnings cap is the appropriate method to capture the benefits for consumers and the impact of rider approval on its cost of capital for those projects.

ComEd witness Crumrine stated in his rebuttal testimony that

> in the event the Commission orders separate processes be undertaken to further consider Smart Grid technologies, such as those proposed by Staff or CUB, many of the threshold issues already will have been addressed by the parties in those processes. Thus, less time should be required to consider these issues in future approval proceedings." ComEd Ex. 30.0 at 14.

The project-by-project consideration may be appropriate, but only in the context of overall smart grid goals approved in the Smart Grid Policy Order. When the Company re-files Rider SMP/SG, appropriate process changes should be addressed.

In summary, Rider SMP is adopted for the limited purpose of implementing Phase 0 of AMI deployment, following the six month AMI Workshops and Commission approval, as discussed above. The results of Phase 0 will be analyzed by ComEd and brought to the Statewide Smart Grid Collaborative. The Statewide Smart Grid Collaborative should begin to immediately consider smart grid policy issues in Illinois. That collaborative process is to be followed by a Commission docket to adopt specific goals and policy framework related to the deployment of a smart grid in Illinois. Thereafter, ComEd may file a plan for implementation and re-file its request for rider recovery of smart grid investments.

C. Rider SEA – Storm Expense Adjustment

1. ComEd

ComEd asserts that it is in the public interest to repair storm-damaged facilities and restore electric service to customers in a safe and timely manner. ComEd further states that it is reasonable for it to recover its actual, prudently incurred costs for storm restoration work. In particular, the Company states that winter and summer storms, which are outside its control, impose material costs that are volatile and fluctuate greatly from year-to-year. For example, in 2007, ComEd's actual storm restoration operations and maintenance ("O&M") expenses were approximately $54.8 million, while such expenses were $38.5 million in 2006 and $17.9 million in 2005.

Proposed Rider SEA is designed to track O&M expenses related to storm restoration work and provide a dollar-for-dollar recovery of such expenses by collecting the incremental difference between the amount allowed in base rates and the previous year's actual storm expenses. ComEd Ex. 11.0 Corr. at 13-16. According to ComEd, a tracking rider for storm restoration expenses is fair and beneficial both to customers and ComEd because it would ensure that it recovers only the actual annual costs it incurs. ComEd contends that the purpose of Rider SEA is to (1) greatly improve the accuracy of the costs that customers must pay for prudently incurred storm expenses; (2) avoid detracting from ComEd's plans to maintain or improve service quality and reliability; and (3) avoid financial harm due to the volatility of such expenses. *Id.* at 15-16.

ComEd notes that Rider SEA does not address each and every storm that takes place in ComEd's service territory during the course of a year. Rather, Rider SEA limits the definition of a "storm" in a manner consistent with current operations. As stated in proposed Rider SEA (ComEd Ex. 30.2), a storm is defined as:

> any act of nature with disturbance of the physical environment in which the Company's service territory is located, including but not limited to thunderstorm, microburst, tornado, cyclone, wind storm, snow storm, blizzard, ice storm, flood, or earthquake, or a system of one or more of such acts, a result of which is the interruption of electric service to, in aggregate, a total of more than 10,000 retail customers each of which are without service for more than three (3) hours, and during or after which the Company activates one (1) or more Emergency Operation Centers (EOCs).

Under its proposal, ComEd's base distribution rates would recover a fixed amount for storm restoration expense annually. This amount is established using a historical average, and would remain fixed until the next rate case. In this instance, ComEd proposes to include approximately $26 million in base rates, consistent with the application of a historical average. Meanwhile, to the extent that ComEd's actual storm restoration expense is higher or lower than the fixed amount reflected in base rates in a given year, Rider SEA would provide the mechanism to either refund an over-collection or apply a charge to recover the shortfall. ComEd Ex. 11.0 Corr. at 14.

In surrebuttal testimony, ComEd proposed combining the proposals of IIEC and DOE regarding cost allocation and recovery mechanism under Rider SEA. Crumrine, ComEd Ex. 43.0 Corr. at 28-29. Under this combined approach, ComEd would determine fifteen separate charges or credits under Rider SEA, one for each distribution class. Such charges or credits would be determined based on the percentage of storm restoration expenses allocated to each class according to ComEd's ECOSS. ComEd proposes to employ a single "automatic reconciliation amount" or "AR" factor to determine the charges or credits for all classes. Accordingly, ComEd proposes to track the total difference between the costs or credits to be recovered or refunded from all fifteen classes and the costs or credits actually recovered or refunded from all classes during the calendar year. ComEd notes that the DOE has accepted this cost-recovery approach.

ComEd's revised proposal for Rider SEA also provides for annual reconciliation proceedings during which the costs recovered through Rider SEA will be subject to review. Thus, ComEd states that the Commission will annually review the reasonableness of ComEd's storm expenses, as well as the classification of costs as storm expenses, ensuring that ComEd recovers no more and no less from its customers than the actual costs prudently and reasonably incurred for storm restoration work. ComEd argues that the annual reconciliation process also addresses the concerns of certain parties that claim that Rider SEA will encourage ComEd to improperly classify costs as storm expenses, or that it might remove incentives for ComEd to prudently control the costs of storm restoration activities. ComEd asserts that the Commission's annual reconciliation process is more than sufficient incentive for ComEd to properly

classify or define a cost as eligible for rider recovery, and to manage its storm restoration efforts efficiently. Indeed, ComEd argues that it has demonstrated that Rider SEA actually improves the determination of how much customers are charged for storm repairs.

According to ComEd, Rider SEA fits comfortably within a standard for rider recovery of expenses that the Commission has recognized and used before. *CUB*, 166 Ill. 2d at 138 ("[A] rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile or fluctuating expenses."). ComEd further states that Rider SEA is a proper mechanism for cost recovery because its storm repair O&M expenses are material, *i.e.*, they involve very large costs, highly volatile from year to year, and are unpredictable and uncontrollable. ComEd asserts that it showed that the wide fluctuation in storm restoration costs, particularly where costs exceed those allowed in current rates, represents a significant portion of ComEd's expected earnings and, therefore, has a substantial negative impact on the financial community and its operations. ComEd Ex. 22.0 Corr. at 9-10.

Contrary to the claims of certain parties, Rider SEA will not provide an incentive for ComEd to lessen its maintenance of its electric delivery system. ComEd asserts that such claims ignore Sections 16-125(e) and (f) of the Act, which make ComEd economically responsible for (1) certain damages incurred by customers and the expenses incurred by units of local government in the event that more than 30,000 customers are subject to a continuous power interruption of four or more hours, and (2) certain damages resulting from a power surge or fluctuation that affects more than 30,000 customers. 220 ILCS 5/16-125(e), (f). Thus, ComEd states that it remains subject to potentially significant economic consequences for failure to properly maintain the electric delivery system and will continue to be subject to such consequences whether or not Rider SEA is approved.

Moreover, preventative maintenance is not aimed at protecting against damage from a serious storm. Instead, preventative maintenance addresses problems anticipated to arise under normal operations, including normal weather events. ComEd Ex. 22.0 Corr. at 8-9. ComEd states that storms create problems that preventative maintenance does not, and is not designed to, prevent. *Id.*

While objecting to Rider SEA, Staff suggested certain modifications to the proposed rider if the Commission finds Rider SEA reasonable. ComEd accepts many of Staff's recommendations relating to Rider SEA, e.g. ComEd accepts Staff's proposed tariff language that would clarify that the costs recovered through Rider SEA are subject to a prudence review during the annual reconciliation proceedings.

In response to Staff's proposals regarding the types of costs that are eligible to be recovered through Rider SEA, ComEd proposes the addition of a new term, "O&M," to further clarify the costs to be recovered. In addition, to the extent Staff proposes the removal of regular wages from both the "Baseline O&M" and "Actual O&M" computations in the Rider SEA formula, thereby reflecting only the incremental labor expense, ComEd does not object to these changes. Further, ComEd accepts Staff's proposal of new tariff language that would help clarify that "Baseline O&M," or the

normalized storm expense reflected in base rates, will not change between rate cases. ComEd Ex. 30.0 at 39-41.

Additionally, ComEd does not object to Staff's proposed language addressing the tests in the internal audit provisions of Rider SEA, with one exception. Staff proposes the following test: "The audit shall further test that costs recovered through Rider SEA are not recovered through other approved tariffs." Because Rider SEA would annually track actual storm expenses and recover or refund any differences between such amounts and the normalized amount reflected in the revenue requirement, *i.e.*, $26 million, some portion of the costs would be "recovered through other approved tariffs" (namely, distribution charges) by operation of the formula in Rider SEA. Staff's proposal fails to reflect the fact that ComEd will be recovering a portion of its annual storm restoration costs through base distribution rates.

Finally, ComEd does not agree with Staff's proposal to change the definition of a "storm" to that used by the National Weather Service, because that definition does not coincide with the events that drive ComEd's response to classify costs as "storm" costs. ComEd Ex. 22.0 Corr. at 10. Specifically, ComEd's asserts that its suggested definition invokes the rider exactly when needed: when, due to an act of nature, ComEd determines that it must open the storm center because 10,000 or more customers have lost power for three or more hours. ComEd Ex. 30.01. ComEd states that the National Weather Service concept, relied upon in Staff's proposal, does not consider the number of customers out of power or the damage that may occur to ComEd's distribution facilities. ComEd argues that Staff's proposal is inconsistent with its operations and the manner in which it records storm restoration costs.

2. Staff

It is Staff's position that the Commission reject the Company's proposed Rider SEA because the costs are not of sufficient magnitude or volatility to justify rider recovery. Furthermore, Staff states that the rider's pass-through mechanism would undermine the Company's incentive to control storm expenses.

Staff disagrees with the Company's position that storm expenses are unexpected, volatile or materially fluctuating. While the Commission has the discretionary authority under the Act in appropriate circumstances to provide for rider recovery (*City of Chicago v. Illinois Commerce Comm'n,* 13 Ill. 2d 607 (1958)), the Company must demonstrate adequate justification. A rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses. *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 138-139 (1995). In this case, the proposed Rider SEA is allegedly supported by Company witness Crumrine who argues that storm expenses are "inherently volatile." ComEd Ex. 30.0 at 31:705. However, according to Staff, the Company has not presented any specific or viable information to demonstrate sufficient volatility to justify rider recovery.

While Mr. Crumrine opines that weather is "unpredictable" and that weather related system costs "can vary by tens of millions of dollars from year to year" (ComEd Ex. 11.0 at 16:298-299), it is Staff's position that the evidence suggests otherwise.

During the six year period from 2002 through 2007, four of the six years were below the $27.1 million inflation-adjusted six year arithmetic average. Also, from 2003 through 2005, the Company's storm expense only varied from the base amount by $2.3 million, $6.5 million and $7.8 million, respectively.

Furthermore, Staff observes, the Company's argument for its proposed rider seems to rely on a single unique storm problem. To support Rider SEA, Mr. Crumrine references the Company's record high 2007 storm expense of $54.8 million, which is 102% of the $27.1 million normalized storm expense proposed for inclusion in base rates, as evidence of volatility. ComEd Ex. 30.0 at 31:700-705. Mr. Crumrine, however, fails to mention the abnormal event, an August 23 storm of unusual severity, which caused such a number to occur. Even if the Commission accepted that the one storm or outlier in 2007 was a volatile occurrence, Staff argues that the August storm alone would not establish sufficient year-to-year volatility to justify rider recovery under SEA.

ComEd witness Williams seeks to bolster the volatility claim by comparing storm expense to a subset of costs (distribution corrective maintenance expense) smaller than the total revenue utilized by Staff witness Mr. Luth (and adopted by Staff witness Lazare) to compare storm expenses.

Staff asserts that Mr. Williams' argument to use the subset of distribution corrective maintenance expense instead of the revenue rate is misplaced. As Mr. Lazare testified, "[i]t is always possible to find some subset of costs to which storm expenses comprise a significant share. The fact that they are 18.8% of corrective maintenance fails to undermine in any way the original contention that storm expenses are not large compared to total revenue." Staff Ex. 18.0 at 31.

Staff asserts that the only fact the Company has demonstrated is that storm costs vary. However, the Commission has stated that cost variations alone do not justify rider recovery. *NS/PGL*; Dockets 07-0241-07-0242/Cons. Order, February 5, 2008, at 188. Likewise, in this case fluctuations in storm-related expense, while expected, are insufficient to trigger frequent general rate proceedings if they are recovered under base rates. Thus, there is no justification to warrant the drastic departure from traditional ratemaking.

Staff has other concerns with Rider SEA. Because Rider SEA provides for full recovery of all storm related O&M expenses on a going-forward basis, Staff argues that it would provide a counter-productive economic incentive to ComEd to reduce or defer planned maintenance of its distribution system and the expenses associated with that planned maintenance so as to shift or convert those maintenance expenses to storm related O&M expense. Staff Ex. 8.0 at 4:70-75. Reduced normal O&M expenditure could be expected to result in lower service reliability to ComEd's customers. *Id.* at 75-81.

Another concern Staff has is with the vagueness of the definition of "storm". Mr. Crumrine dismissed the assertion that an incentive would exist, in a Rider SEA environment, to unsuitably classify or define a cost as eligible for recovery under the rider. Mr. Crumrine states that any attempt to inappropriately reclassify costs as storm expenses in order to recover them through the rider would be foolish and shortsighted.

ComEd Ex. 30.0 at 33-34. However, the real risk lies in trusting that a proper classification of expenses related to Rider SEA would be self-policing. Staff states further that storm repairs are not all black and white issues; some are gray. Mr. Crumrine himself stated, "…it is possible that a storm might cause some repair work that was already scheduled for some point in the future, such as the replacement of a broken pole that was scheduled to be replaced…" ComEd Ex. 30.0 at 36. The Commission must guard ratepayers against the potential for shifting of risk and costs.

The Company agues that there are other adequate mechanisms in place to assure ComEd will continue to adequately maintain its system if Rider SEA is in place. For example, Mr. Crumrine references Sections 16-125(e) and (f) of the Act as evidence that there exists potentially significant economic consequences for failing to properly maintain its distribution system. Staff counters by stating first, Dockets 07-0491 and 08-0044 are open docketed cases filed by ComEd before the Commission addressing Section 16-125(e) of the Act. In both of these dockets, ComEd is asking the Commission to grant it a waiver from the requirements of subsection (e) based on the statutory provisions allowing a waiver when the power interruption is the result of unpreventable damage due to weather events or conditions. Additionally, ComEd's verified Petitions in Dockets 07-0491 and 08-0044 request that the Commission enter an Order determining that Section 16-125(e) of the Act is not applicable to interruptions resulting from the storms referenced therein, based on ComEd's assertion that the interruptions that resulted should be viewed as thousands of separate interruptions that all fall under the threshold of 30,000 customers interrupted for four hours or more contained in Section 16-125(e) of the Act. According to Staff, ComEd's interpretation of Sections 16-125(e) and (f) of the Act would not provide ComEd the necessary economic incentive to properly maintain its distribution system.

Also, Mr. Crumrine warns of "…foregone opportunities for investment in the distribution system" in the absence of Rider SEA. ComEd Ex., 30.0 at 32:725-726. Staff notes, however, that he fails to explain what those forgone opportunities might be. Clearly ratepayers wish to receive reliable service. Nonetheless, Staff posits that it would be bad policy to approve Rider SEA based on some vague notion of "forgone opportunities" that would be lost.

Additionally, Mr. Crumrine attempts to downplay the significance of the financial impact to ratepayers by stating that distribution charges represent a "relatively small percentage of customers' bills." ComEd Ex. 30.0 at 35:790-791. However, Staff argues that Mr. Crumrine ignores the fact that distribution charges are not the only part of ratepayer bills that have been rising since the expiration of the rate freeze. Ratepayers recently absorbed an increase in transmission rates and will receive an increase in power costs on June 1, 2008. With all bill components on the rise, Staff asserts that ratepayers may not want to be exposed to further increases under Rider SEA.

Staff notes that ComEd witnesses have not conducted any specific research into any rider or tariffs approved for an electric utility in other jurisdictions to determine any similarities to ComEd's proposed Rider SEA.

Furthermore, according to Staff, ComEd's argument disregards the fundamental concepts underlying the normalization of certain expenses in base rates. While virtually

all expenses are subject to some variability, the general practice is to set rates based on the test year expenses presented by the utility. An exception to this general practice is followed for certain expenses where the test year amount does not represent a normal level of expense. A normalized level of expense is typically developed through an averaging of the subject expense over a period of time. While the normalized amount recovered in any given year may vary from the actual amount incurred in any given year, the amount recovered over time will generally equal the actual amount incurred over time. The variability which justifies normalization of certain expenses is not the same as the variability that justifies rider recovery; rather, normalized expenses are recovered through base rates.

The Company attempts to bolster its contention of volatility by stating that weather is "unpredictable" and that weather related system costs "can vary by tens of millions of dollars from year to year." ComEd Init. Br. at 87-88; ComEd Ex. 11.0 Corr. at 16:298-299. However, Staff responds, storm restoration expenses fell below the average for four out of the past six years. During the six year period 2002 through 2007, four of the six years were below the $27.1 million inflation-adjusted six-year arithmetic average.

The Company also compares ComEd's net income to variance in storm expenses from year to year, arguing that "such a variance in expense represents a significant impact." ComEd Init. Br. at 84. Such a comparison, Staff responds, is not relevant to determining whether Rider SEA should be favored over traditional base rate regulation. Staff countered that storm restoration expenses are not significant in comparison to total operating expenses. Staff also notes that to assess whether a particular expense warrants rider recovery, the courts have found that the relevant comparison is to other operating expenses. In *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317 (1st Dist. 1993) the court held that DSM related expenses were ordinary expenses not entitled to special rider treatment, and in so holding relied explicitly on the fact that the expenses for which rider recovery was sought "reveal no greater potential for unexpected, volatile or fluctuating expenses which Edison cannot control, than costs incurred in estimating base ratemaking." *Id.* at 326-327. Applied to the instant case, Staff contends that the *Finkl* opinion demonstrates that Staff's comparison of Rider SEA expenses to total operating expenses is the more relevant comparison; and rider recovery is not justified, because storm restoration expenses are not significant in comparison to the Company's total operating expenses.

In its Initial Brief, ComEd also seeks to counter the argument of Staff witness Luth that Rider SEA would create "an incentive to classify or define a cost as eligible for recovery under a rider." Staff Ex. 6.0 at 17. ComEd claims this concern is unfounded because "[a]ny inappropriate classification of costs as storm expenses would be subject to Commission review in the annual reconciliation proceeding in the immediately following year." ComEd Init. Br. at 89. Additionally, Mr. Crumrine dismissed the serious potential or incentive that would exist under Rider SEA for the Company to inappropriately classify or define a cost as eligible for recovery under the rider. Mr. Crumrine states that any attempt to inappropriately reclassify costs as storm expenses

in order to recover them through the rider would be foolish and shortsighted. ComEd Ex. 30.0 at 33-34.

Thus, the Commission should not approve Rider SEA because ComEd has not established that the costs to be recovered under Rider SEA are sufficiently volatile, fluctuating, unpredictable, or unique. Staff avers that it would be poor public policy to approve Rider SEA.

If the Commission determines it is appropriate for the Company to recover the O&M expenses related to storm restoration through a rider, Staff recommends the Commission adopt language changes to the ComEd Rider SEA exhibit (ComEd Ex., 30.2) to address: 1) subjectivity in the definition of Storm; 2) terminating certain customer charges if ComEd service deteriorates significantly; 3) establishing a prudency requirement; identification of recoverable costs; and internal audit requirement; and 4) setting a baseline O&M amount to remain constant between rate cases.

3. DOE

According to the DOE, ComEd's proposed Rider SEA single cents-per-kWh charge/credit mechanism would create cost mismatches because most storm damage expense covers restoration of parts of the secondary distribution system, which never serves the largest customers. The Company proposes to merge DOE's and IIEC's proposed alternative mechanisms by using the COSS to determine the classes' SEA cost/credit responsibilities, and recover or disburse them via class-specific charges/or credits. DOE will accept this if the Commission adopts SEA. If it does this, the Commission should state that it is using the COSS for only this limited purpose and that this usage does not mean it accepts the COSS or that the COSS's failure to disaggregate costs by voltage does not render it unacceptable for revenue allocation and rate design.

4. AARP

AARP opposes the proposed Rider SEA. As with the Rider SMP proposal, this mechanism, AARP argues, is also a single-issue adjustment that suffers from almost all of the same ratemaking deficiencies described in the policy arguments for Rider SMP.

Currently, ComEd recovers its prudently incurred storm restoration expense through base rates. A normalized annual allowance of prudent storm restoration cost is included in operating expenses in determining ComEd's base rates. AARP avers that ComEd has not demonstrated that this current method of addressing the recovery of storm restoration expense, *i.e.*, via the allowance of a normalized amount of such expense in operating expenses in the setting of base rates, is inadequate. ComEd has failed to show why this expense should be granted special single-issue treatment, thus shifting the burden and responsibility for fluctuations in storm restoration expenses occurring between rate cases away from shareholders and onto ratepayers.

AARP asserts that the Company could remove or reduce incentives to prudently control the cost of storm restoration activities. They state further that storm restoration costs are not similar to fuel costs or generation supply costs that are more justified for

single-issue treatment. In addition, AARP argues that Rider SEA is a single-issue ratemaking and a dollar-for-dollar cost recovery mechanism that could encumber ratepayers with additional annual revenue requirements for storm restoration costs between rate cases, even during periods in which ComEd is otherwise earning a fair rate of return. Rider SEA distorts test year relationships. ComEd originally proposed to audit its own storm expenses for the purpose of this rider. Having the utility "audit" its own costs, AARP counters, would be like having the Company (rather than an independent agency such as the IRS) "audit" its own tax returns. AARP Ex. 1.0 at 20. According to AARP, even the revised proposal which includes a tighter definition of O&M expenses and specific tests for the internal audit provisions is not sufficient to cure the fundamental problems with Rider SEA. AARP Ex. 2.0 at 11-13. It is also not clear from the language in ComEd's proposed rider whether it would be ComEd's internal audit department personnel conducting the review. AARP Ex. 2.0 at 16. An internal audit functions independently of the utility's accounting and finance departments and of its regulatory affairs staff. AARP Ex. 2.0 at 16. Independent auditing would be more reliable, although this would not cure the problems associated with the single-issue nature of this mechanism.

Although ComEd claims that consumers are treated more fairly with a dollar-for-dollar tracking mechanism, AARP asserts that this is not the case. While a single-issue exact recovery tracking-type rider would ensure that recovery of the tracked expense is limited to actual costs, storm restoration expenses should not be singled-out from other O&M expenses, which also fluctuate between rate cases. Rider SEA is severely flawed and would be harmful to retail customers because it would allow the Company to single-out and charge ratepayers for differences in annual storm restoration costs above a base amount, even during annual periods when ComEd is otherwise earning a reasonable return. In other words, ComEd's proposed Rider SEA suffers from one of the fundamental flaws of single-issue ratemaking and could thus result in charging ComEd's ratepayers for increased storm restoration costs even during periods in which the Company is over-earning.

AARP disagrees with ComEd witness Williams' method for the calculating the impact of Rider SEA and believes that method should be rejected. ComEd Ex. 22.0, pp. 9-10. In terms of evaluating whether a special rider is needed for storm restoration expenses, AARP agrees with Staff witness Luth and AG/CUB witness Brosch that a more appropriate method for evaluating Rider SEA is needed as to its relationship to the utility's total revenue. Moreover, because ComEd's storm restoration expenses are not large compared with total revenue, AARP argues that this is another way in which this proposal is unlike the situation associated with an electric utility's fuel and purchased power costs. AARP Ex. 2.0 at 13. Consequently, a special rider for between rate case fluctuations in storm restoration expenses is unnecessary.

ComEd claims that annual prudence reviews of the reasonableness of its storm expenses should alleviate concerns with regard to reducing the incentives on the Company to control the costs of storm restoration activities. AARP disagrees. An after-the-fact prudence/reasonableness review, while being necessary if Rider SEA is to be adopted, does not provide the same incentive on utility management as having

shareholders be responsible for cost fluctuations between rate cases. AARP Ex. 2.0 at 14. Currently, ComEd is responsible for annual fluctuations in storm restoration expenses that occur between rate cases. Rider SEA would make ratepayers responsible for the annual fluctuations in storm restoration expense recorded in Account 593. Consequently, even with an annual review, AARP states that the incentives to control storm restoration costs that are currently in place would be lessened by Rider SEA.

As explained above with regard to Rider SMP, AARP would find it burdensome to have to protect the interests of its residential ratepayer members in numerous annual prudence review cases, as opposed to occasional general rate cases. The resources of AARP and other small Intervenors will constrain their abilities to meaningfully participate in such reviews.

5. Nucor

Nucor argues that ComEd has presented no compelling reason to impose yet another single-issue ratemaking scheme that ignores ComEd's overall financial position, reduces its incentive to control incremental storm-related O&M expenses, and creates a mismatch between cost responsibility and cost recovery. According to Nucor, the Commission should reject ComEd's proposed Rider SEA.

6. CG

CG notes that Illinois is not a hurricane prone state like Florida or Louisiana, so there is less need for a storm expense rider in Illinois than there may be in other states. CG agrees with Mr. Brosch that the SEA mechanism would shift all storm restoration risks to ratepayers. AG/CUB Ex. 4.0 at 49. ComEd has not demonstrated the need for such extraordinary relief from standard cost recovery, and therefore, CG does not support approval of the SEA rider.

7. CTA

Rider SEA has the same deficiencies as does Rider SMP and the CTA believes it should be rejected by the Commission. The CTA agrees with Staff that Rider SEA does not meet the criteria for rider cost recovery.

8. Metra

Metra believes that proposed Rider SEA should not be approved because it does not involve the kind of unexpected, volatile or fluctuating expenses that would otherwise cause problems for ComEd; it suffers from the same procedural defects as Rider SMP; and it would allow ComEd to perform routine maintenance and include them in its Rider SEA costs whenever there was an eligible storm.

ComEd has never addressed the costs and problems associated with multiple mini-rate cases and overlapping reconciliation proceedings. At bottom, Metra submits that there is no good reason to treat storm expenses differently from other variable expenses, and therefore no justification for Rider SEA.

9. AG

ComEd witness Crumrine defines the “storm event” that would qualify for Rider SEA treatment and the Company commits to perform an annual audit of the O&M expenses it incurs that would be eligible for Rider SEA consideration. ComEd Ex. 11.0 at 14. The AG points out that historically, ComEd has incurred storm restoration costs in two forms: (1) costs that are associated with the removal and replacement of damaged units of utility plant, where the costs are capitalized and included in rate base; and (2) costs that are incurred and expensed for re-fusing, emergent switching, pulling slack and reinstalling fallen wire, vegetation/tree trimming, splicing, sleeves, re-lamping and repair or replacement of distribution system parts that are not units of property (not capital). AG/CUB Ex. 1.0 at 39-40. The capitalized plant replacement costs are routinely added into rate base and are subject to recovery through ongoing accruals of depreciation expense. These capitalized storm restoration costs are not, argues the AG, the subject of proposed Rider SEA.

For the expensed storm restoration charges, the Company has included in base rates a normalized test year amount for storm restoration expense that tends to vary somewhat from actual costs incurred in particular years. ComEd’s most severe and costly storm restoration effort was on August 23, 2007, when expenses of $31.9 million and capital costs of $17.4 million were incurred in connection with a single storm event. AG/CUB Ex. 1.0 at 41. In Docket 05-0597, the Commission established rates including recovery of a five-year normalized amount of storm restoration expenses totaling $18.3 million. In subsequent years, any difference between actual expenses and this authorized level was absorbed by shareholders.

In the instant case, ComEd is proposing a similar type of averaging calculation to include a normalized cost level within the revenue requirement, but employing an inflation-adjusted, six-year average storm restoration expense level of $27.1 million. Using this average expense level, the Company is proposing to reduce the abnormally high test year actual 2006 storm expense by about $11.4 million. If Rider SEA is approved, future actual storm expenses that are higher or lower than the normalized baseline level of $27.1 million would result in credits or charges to customers through the proposed new rider.

The AG urges the Commission to reject Rider SEA. First and foremost, the AG argues that Rider SEA creates piecemeal regulation for an isolated element of the revenue requirement (storm restoration expenses) that is more properly captured using traditional test year regulation. Additionally, Rider SEA has the following problems:

- Rider SEA is ambiguously vague and will not withstand judicial scrutiny;
- Rider SEA fails several of the generally accepted tests for rider recovery (storm expenses not large, not beyond control of management, not volatile);
- ComEd has not demonstrated a financial need for Rider SEA;
- Rider SEA will not stabilize ComEd financial performance;
- Rider SEA may result in over-recovery of ComEd labor costs;

- Rider SEA is not subject to effective Commission monitoring.

The AG is concerned that Rider SEA will require ratepayers to pay the actual storm expenses incurred by ComEd each year, instead of subjecting the storm costs to regulatory scrutiny in periodic rate case test periods. As discussed by AG/CUB witness Brosch, Rider SEA, as well as Rider SMP, removes the incentive for management to control and reduce costs, so as to maximize the opportunity to actually earn at or above the authorized return level between rate case test periods. The AG incorporates the same arguments it made against Rider SMP, namely, that traditional ratemaking causes the shareholders to bear (i) the burden of any costs associated that were not accounted for in the previous rate case and (ii) the gains from efficiencies that are created between rate cases. The AG maintains that such a rider for storm expenses incurred above a designated level reduces management's incentive to maintain the delivery system, since costs are passed on to ratepayers. Rider SEA, the AG maintains, like all riders, shifts the risk associated with this particular expense item on to ratepayers while shareholders gain from the reduced incentive to maintain the system.

The AG also urges the Commission to reject Rider SEA because it contains a plethora of ambiguous and vague language that renders it defective. The proposed rider would apply when, "in aggregate, a total of more than 10,000 retail customers" each lose power for more than 3 hours, "and during or after which the Company activates one (1) or more Emergency Operation Centers (EOCs)." The AG asserts that the language defects will allow ComEd to easily satisfy the "more than 10,000" customer requirement by (i) aggregating customers affected by different storms within ComEd's service area, (ii) aggregating customers who were affected by storms weeks or months apart, and (iii) aggregating customers who were not affected by something other than a typical storm.

The AG describes how ComEd's definition of a storm in the tariff permits the Company to seek Rider SEA treatment even though there were no storms or storm systems. The definition of a "storm" describes events that are clearly storms or storm systems, such as tornadoes, cyclones, snow storms, blizzards, etc., but it also allows the Company to recover for "any act of nature with disturbance of the physical environment." ComEd Ex. 12.18, Original Sheet 623.

Additionally, the AG argues that by allowing ComEd to collect a rider for almost any weather related event, there will be no reasonable basis for the Commission, Staff and Intervenors to determine if certain interruptions were caused by the weather or by an aging system. The AG asserts that ComEd could refuse to make required repairs to certain facilities until there is a "storm" and the Company can collect the costs of those repairs from ratepayers. The AG argues that Rider SEA should be rejected because ComEd's definition of what constitutes a storm for purposes of triggering Rider SEA surcharges is clouded by vagueness and ambiguity.

Further, AG/CUB witness Brosch argues that the severity and frequency of storms is clearly beyond the control of ComEd and the expenses incurred are driven by storm activity which can vary significantly from year to year. Mr. Brosch, however, states that the expense amounts involved with storm restoration are not particularly large in relation to the Company's total O&M expense or its overall revenue

requirement. AG/CUB Ex. 1.0 at 42. In support of this, he cites to the historical variation of actual expenses that comprise the proposed normalized test year expense that ComEd proposed in its direct testimony ($27.1 million), which ranges from a low of minus $19.2 million (actual expense in 2002 was $7.9 million) to plus $34.2 million (preliminary actual expense in 2007 is $61.3 million). *Id.* This volatility of plus $34.2 million in the year 2007, which contained the largest storm in known history (August 2007), is only about 4.2 percent of total test year O&M expenses, and such volatility is much lower in all other years. Id. The 2007 variation in storm expenses above average levels is less than 2% of the Company's overall revenue requirement. *Id.*

Additionally, AG/CUB witness Brosch states that storm restoration expenditure levels are not entirely beyond the control of management, whose first priority should always be public safety and the restoration of utility service as quickly as possible. This is due to the need for management to prudently plan and manage restoration activities to optimize the utilization of resources, such as the Company's vegetation management plan, which is intended to, among other things, minimize the scope and duration of outages caused by storm events, which can directly impact the scope of storm restoration costs. AG/CUB Ex. 1.0 at 42-43. Mr. Brosch also noted that the implementation of the hazard tree removal program attempts to address the scope and duration of future outages caused by storm events. *Id.* at 43. The AG argues that ComEd simply is in a better position to minimize the scope of storm restoration costs than are ratepayers.

The AG cites to ComEd's failure to demonstrate a financial need for Rider SEA as yet another reason to reject the tariff. The substantial evidence of the record supports the conclusion of AG/CUB witness Brosch, Staff witness Luth and AARP witness Smith that Rider SEA is not needed to reflect a normalized level of storm expenses in customer rates. The AG states that the storm expense amounts are not large in relation to the Company's total O&M expenses or revenue requirement. The 2007 variation in storm expenses above average levels is less than 2% of the Company's overall revenue requirement.

The AG asserts that the Company produced no evidence that recent changes in their operations will preclude it from earning reasonable returns in the future under traditional regulation if Rider SEA is not approved. AG/CUB witness Brosch further testified that nothing prevents ComEd from collecting storm restoration expenses under current practice. ComEd's current overall cost of service includes an allowance for storm expenses based upon a normalized average of the historical costs that have been incurred and ComEd has been able to function properly for many years without Rider SEA.

Mr. Brosch noted that fluctuations in storm restoration expenses are fully recognized in the multi-year averaging approach being employed in this docket to calculate normalized amounts included for base rate recovery. While the Company may over-recover its actual expenditures in certain years and under-recover in other years, its actual expenses over future time periods should be fully recovered under the approach that is traditionally used by ComEd and other utilities for recovery of such

costs. AG/CUB Ex. 1.0 at 47. Additionally, the AG points out that there is no other utility that ComEd can identify that has a rider similar to Rider SEA. *Id.*

The AG concludes that while ComEd complains that a static amount of storm expense built into a revenue requirement will never adequately approximate the actual costs incurred, this is true of many types of expenses that are normalized for ratemaking purposes. AG/CUB Ex. 4.0 at 48. With full recovery of a normalized, ongoing cost level in base rates, the expectation for Rider SEA should be for both positive and negative customer impacts from future year-to-year that tend to net toward zero over extended periods of time. As long as the overall revenue requirement is reasonable, it is of little consequence when the individual components of the revenue requirement for wages, benefits, sales volumes, bad debts, contract labor and most other costs deviate from rate case allowed levels.

According to the AG, it has established that significant and varying amounts of ComEd labor are included in storm expenses eligible for rate tracker treatment. ComEd Response to Data Request No. AG (MLB) 2.19. Rider SEA would adjust delivery rates for labor cost changes from year-to-year that are charged to storm tracking projects, even though the Company is unlikely to hire new employees and then later reduce staffing levels because of storms, according to the AG. The AG maintains that storm restoration work is instead accomplished by deferring other work and/or requiring overtime services from existing employees. Rider SEA could easily result in unreasonable rate recovery of Company labor costs that were fully included in test year expenses for the conduct of O&M activities other than storm restoration.

The AG identifies that Rider SEA does not allow any meaningful examination of the prudence or reasonableness of storm expenses that ComEd collects from ratepayers. The only monitoring requirements provided for in the Company's proposal are that ComEd (i) conduct an annual audit of the O&M expenses it incurs to restore service following interruptions due to storms; and (ii) submit an annual verified report to the Commission that summarizes the audit. The Commission can only "reconcile the actual amounts collected under this rider [SEA] with actual prudently incurred O&M". ComEd Ex. 30.02 at 4. The AG points out that ComEd does not have to prove that revenues collected under Rider SEA are reasonable or prudent, but only submit to a reconciliation of amounts actually collected.

The AG states that this process makes contesting ComEd's classification of Rider SEA costs next to impossible, especially considering ComEd will have an incentive and unfettered authority to list normal replacement or other costs as storm expenses to get ratepayers to bear the burden of these costs pursuant to Rider SEA. *Id.*

The AG makes the same arguments as in the Rider SMP section, namely, that the Commission must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single-issue ratemaking. *BPI II*, 146 Ill.2d at 195. Instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, ComEd's Rider SEA proposal tracks changes in storm restoration expense in isolation, which the AG asserts ignores

the totality of rate base, expense and revenue circumstances, and thereby constitutes illegal single-issue ratemaking. The AG asserts that Rider SEA, similar to Rider SMP, ignores the traditional ratemaking process, which employs a balanced review of jurisdictional expenses, rate base investment, the cost of capital and revenues at present rates during the test year. If enacted, the AG argues that Rider SEA would violate the Act's prohibition against single-issue ratemaking by imposing a surcharge on customers' bills when these expenses exceed the established baseline level, without examining whether the Company's overall cost of service and revenue requirement have increased. *Id.*

Similar to its arguments in Rider SMP, the AG argues that Section 9-201 of the Act ensures that rates for utility service are set prospectively. 220 ILCS 5/9-201. Once the Commission establishes rates, the AG declares that the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. *BPI I*, 136 Ill.2d at 209; *Citizens Utilities Co.*, 124 Ill. 2d at 207.

The AG asserts that Rider SEA violates the prohibition against retroactive ratemaking by generating monthly surcharges based on the difference between (1) a specified baseline amount for O&M expenses related to storm restoration and (2) such actual expenses incurred during the previous calendar year. ComEd Ex. 11.0 at 13 The AG takes issue with the tariff's annual reconciliation of Rider SEA charges, in which surcharges are reconciled with actual storm restoration expenses, and argues that it constitutes another retroactive adjustment of rates similar to the reconciliation ruled illegal in the *Finkl* decision, wherein the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudency review, calling it a violation of the rule against retroactive ratemaking. *Finkl*, 250 Ill. App.3d 317 at 329.

Similar to its objections to Rider SMP, the AG objects to approval of Rider SEA because it violates test-year principles by selecting only one component of the revenue requirement, in this case storm restoration expenses, tracking changes in that revenue requirement component and then assessing rate adjustments to recognize this change. The AG notes that the purpose of the test-year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *BPI I*, 136 Ill.2d at 219. The establishment of a test year jurisdictional operating income is a critical component of the calculation of each company's revenue requirement.

The AG notes that the Act makes multiple references to the mandate that utility rates be least-cost. See 220 ILCS 5/1-102, 1-102(a), 8-401. The AG argues that implementation of Rider SEA will permit piecemeal rate increases for storm expense amounts that exceed the baseline level established for purposes of the rider tariff. The AG maintains that increasing rates for discrete expense items on a monthly basis for expense items that do not satisfy the legal criteria for permissible rider treatment without examining what is happening with other revenue requirement elements, such as overall revenues or cost of capital, may create rates that are not least cost.

10. CUB

CUB adopts the arguments of the AG on Rider SEA.

11. IIEC

IIEC recommends the Commission reject ComEd's proposed Rider SEA. IIEC states that storms and their related expenses are nothing new to utilities, and ComEd has operated for decades without a separate storm expense adjustment, relying on traditional ratemaking of those expenses. IIEC asserts ComEd has not provided a compelling reason to warrant this special rider treatment and therefore it should be rejected.

IIEC argues Rider SEA shifts significant risk from the utility to the utility's customers. IIEC notes that historically, ComEd has borne the risk of varying storm expenses and has been compensated under base rate treatment for such expenses. IIEC believes continued diligence in maintaining its distribution system will likely lessen ComEd's storm expenses. IIEC believes the expense can, to an extent, be controlled by ComEd. IIEC Ex. 1.0-C at 36:760-764.

IIEC points out that, like Rider SMP, Rider SEA has the potential to violate the rule against single-issue ratemaking. Each of the expense adjustments that occur in the future can be made without regard to other changes that may lower ComEd's overall revenue requirement. It is improper to consider changes to components of the revenue requirement in isolation. *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, (1993) 250 Ill. 3d 317, 325, 620 N.E.2d 1141, 1993 Ill. App. LEXIS 833.

IIEC argues Rider SEA distorts incentives for prudent and efficient utility operation. Knowing that the rider would assure it will accrue a dollar-for-dollar recovery of any storm related repair expenses, ComEd would have an economic incentive to reduce its present expenditures on preventive measures covered by base rates, in favor of Rider SEA recovery of later spending for storm damage repair, according to IIEC.

IIEC contends Rider SEA has the potential to introduce cross subsidies and therefore, it should be rejected. However, if it is approved by the Commission, IIEC recommends a more cost-based allocation of the Rider SEA surcharge/credit. IIEC avers, depending on the cost of service study approved in this case, it should be a relatively straightforward matter to determine, for each customer class, the relative share of the normalized base rate expense. IIEC argues that Rider SEA revenue deemed collectible from each class should be collected on a demand basis for those classes for which the distribution facilities charge ("DFC") is collected on a demand basis and on an energy basis for the residential class and smallest non-residential customers, without demand meters, since base rates are charged in that way.

12. Commission Analysis and Conclusion

The Commission has the authority to approve riders in the appropriate circumstances. The Company, however, has not shown that this is the appropriate circumstance.

Staff's Initial Brief succinctly sums up the problems with Rider SEA by stating that "costs are not of sufficient magnitude or volatility to justify rider recovery. Furthermore, the rider's pass-through mechanism would undermine the Company's incentive to control storm expenses." Staff Init. Br. at 82.

ComEd has not provided a compelling reason to warrant this special rider treatment for costs that are typically recovered through base rates. Variations in storm expenses are adequately addressed through normalization, which alleviates concerns that the test year expense might be an anomaly. The addition of a yearly reconciliation proceeding adds unnecessary complexity to a cost that has historically been recovered through base rates.

For these reasons, Rider SEA is denied.

D. Rider SAC – Supply Administration Charge

Rider SAC has been withdrawn.

VIII. Cost of Service and Allocation Issues

A. ComEd

Overview

ComEd asserts that its embedded cost of service study ("ECOSS") is reasonable and should be used to set rates in this proceeding. The ECOSS establishes the interclass allocation of embedded distribution and customer costs among the retail delivery service classes and develops the unit costs. ComEd Ex. 13.0 Corr. at 5-6. The basic structure of the ECOSS is substantially similar to the ECOSSs filed by ComEd and approved in ComEd's last three delivery services rate cases, Dockets 99-0117, 01-0423, and 05-0597. The results of its proposed study are similar to the results of its prior studies. Staff recognizes that the ECOSS is substantially similar to the study approved in ComEd's last rate case and proposes no adjustments in this proceeding. Staff Ex. 6.0 at 3. ComEd states that the AG supports its proposed residential rate design, which is based upon the ECOSS. Also, ComEd cites to the fact that the CG recognized that the updated ECOSS is "reliable enough for setting rates" in this proceeding. In short, the record demonstrates that its proposed ECOSS provides a reasonable basis for setting rates in this proceeding.

ComEd responded that the Commission previously has rejected many of the suggested modifications to the ECOSS and the record fails to support those proposals in this proceeding—i.e., the minimum distribution system ("MDS") and average and peak ("A&P") proposals. ComEd observes that parties such as IIEC, DOE, REACT, CTA and Metra each claim that the ECOSS is fatally flawed because it does not adopt the MDS approach. However, ComEd argues that these parties ignore the Commission's Order in its last rate case. ComEd states that in rejecting requests that ComEd be ordered to include an MDS approach in the ECOSS in its next rate case, the Commission was clear:

> In the Commission's view, it would be unreasonable to require ComEd to perform a COSS that incorporates a method … that the Commission has repeatedly rejected. *Docket No. 05-0597, Order at 165 (emphasis added).*

As such, the fact the ECOSS does not contain the MDS approach does not, in and of itself, render the ECOSS inappropriate.

ComEd then responds to the claims of various large customers who suggest that the ECOSS is flawed, thus requiring various adjustments to the study, or urging outright rejection of the study. ComEd stated that the purpose of such claims is twofold: (1) these parties seek to invalidate the ECOSS in an effort to avoid paying their fair share of costs, in the hopes of an across-the-board revenue allocation; or (2) to shift the burden of cost recovery to other customers, to the greatest extent possible. ComEd Ex. 33.0 Corr. at 14; ComEd Ex. 30.0 at 44. ComEd asserts that the most notable example of this effort to shift costs is the proposal of IIEC. ComEd states that adopting IIEC's MDS approach and primary/secondary split proposal would result in $274 million in costs being shifted from nonresidential customers to residential customers. IIEC's proposed shift in cost recovery would produce a 55% increase in proposed distribution rates for residential customers, as opposed to the 24% increase proposed by ComEd. Tr. 2246-47. ComEd further states that various other large customers, such as the CTA and Metra, support the IIEC's proposal. However, ComEd observes that none of the proponents of the MDS approach or the primary/secondary split proposal address this economic impact on residential customers in testimony or in their briefs. ComEd concludes that the IIEC's proposal provides an example of the "tug of war" between customer classes when it comes to cost allocation and rate design, as described in the testimony of ComEd witnesses Crumrine and Heintz.

ComEd also asserted through testimony that claims that the ECOSS produces "illogical" results, or that it produces rates inconsistent with other utilities are baseless. It is ComEd's position that the results of the ECOSS are similar to prior studies that have been accepted by the Commission. Comparisons to other utilities' rates are also inappropriate. ComEd's testimony notes that many of the attributes of ComEd's large customers simply do not equate to that of Ameren's. As such, rate comparisons are inapposite to the evaluation of whether ComEd's ECOSS is appropriate.

Rather than proposing a cost study that purposefully seeks to shift costs to particular customers, ComEd's ECOSS is consistent with similar studies previously approved, allocates costs in a reasonable and appropriate manner, and its results are in line with prior studies. Accordingly, ComEd urges the Commission to approve its updated ECOSS.

Primary/Secondary Split

ComEd argues that a primary/secondary service differentiation in the ECOSS is neither practical nor necessary. ComEd does not, and is not required to, record its gross plant or accumulated depreciation on its books in a manner that would facilitate changing the ECOSS to recognize the primary/secondary distinction. ComEd Ex. 33.0 Corr. at 3. Moreover, ComEd reiterates that the ECOSS follows the basic structure of the ECOSSs filed by ComEd and approved in ComEd's last three rate cases—Dockets

99-0117, 01-0423, and 05-0597. And, ComEd states that none of these prior cost studies included such a distinction, nor was such distinction required by the Commission. That is, none of the three separately allocated to customers the costs associated with primary voltage (> 4 kV) distribution facilities and the costs of secondary voltage (< 4 kV) distribution facilities.

Contrary to the claims of various large customers, ComEd argues that the lack of a primary/secondary split does not render the ECOSS fatally flawed. In fact, claims surrounding the primary/secondary split affect only a tiny fraction of ComEd's customers. ComEd states that IIEC witness Stowe concedes this point in his testimony. IIEC Ex. 3.0 Corr. at 14. ComEd also points to the fact that Staff made this same point in its Initial Brief, stating that the absence of this distinction does not render the ECOSS inappropriate for setting rates. In addition, various nonresidential customers, such as those represented by the CG, recognize that the ECOSS is adequate for setting rates in this proceeding.

ComEd also presented evidence purporting to demonstrate that its proposed rate mitigation plan will more than amply adjust for any claimed economic impact resulting from the absence of a primary/secondary split. Through the panel testimony of ComEd witnesses Mr. Alongi and Dr. Jones, ComEd argues that its mitigation proposal would reduce rates for large customers below what would result under IIEC witness Stowe's study. ComEd Ex. 45.0 at 4. Accordingly, there is no need to further reduce rates for large customers.

Finally, in addition to being problematic, ComEd notes that adopting this proposal likely will lead to costs being shifted to the residential and small business customers. However, in the event the Commission believes a primary/secondary split of distribution lines is appropriate, ComEd proposes: (1) that the Commission order that such a split be included in ComEd's next filed ECOSS; and (2) that the Commission approve the current updated ECOSS as proposed, because requiring a primary/secondary split is simply a refinement to an ECOSS structure that has been repeatedly accepted.

Minimum Distribution System

Consistent with the cost causation methodology underlying the ECOSSs submitted in its three previous delivery service rate cases and the Commission's Orders approving those ECOSSs, ComEd stated that its proposed ECOSS does not reflect the MDS concept. ComEd points out that the Commission has soundly rejected MDS proposals in the past and should do so again here. See, e.g., Docket 05-0597, Order at 164-65; see also, *Central Ill. Light Co.*, Dockets 06-0070/0071/0072 (Consol.), Order at 160-61; *Central Illinois Public Service Co.*, Docket 00-0802, Order at 42 (citing to Docket 99-0121 at 71). ComEd cites to its last rate case order wherein the Commission stated:

> Based on the record in the instant case, ComEd believes the Commission should reject the minimum distribution or zero-intercept approach recommended by IIEC and BOMA for purposes of allocating distribution costs between the customer and demand functions. In the Commission's view, ComEd's method is consistent with the fact that distribution systems

> are designed primarily to serve electric demand, and the Commission believes that attempts to separate the costs of connecting customers to the electric distribution system from the costs of serving their demand remain problematic. Furthermore, this conclusion is consistent with the decisions in Dockets 99-0121 and 00-0802. Docket 05-0697, Order at 164-65.

While the Commission stated that it was willing to consider the MDS approach in future rate cases, ComEd argues that proponents of the MDS approach have failed to demonstrate why the Commission should diverge from its prior orders and shift tens of millions of dollars in cost recovery burden to residential customers.

ComEd showed that the nonresidential customers that support the MDS concept do so for one obvious reason: the MDS concept would shift costs away from nonresidential customers and on to residential customers. This shift occurs because, under the MDS approach, the basis for allocation of costs is the number of customers rather than customer demand. Because residential customers are far more numerous and use relatively less power than non-residential customers, the effect of the MDS is to shift substantial costs from the non-residential customers to the residential customers. ComEd Ex. 33.0, Corr. at 14. No new evidence has been provided in this proceeding supporting the use of the MDS concept and, accordingly, the Commission should again reject the MDS concept.

ComEd notes that the record fails to support IIEC witness Stowe's MDS proposal. ComEd points to the testimony of its witness, Alan Heintz, who presented ComEd's ECOSS and also explained why the MDS approach continues to be inappropriate. ComEd notes that Mr. Heintz has presented the ECOSS in ComEd's last three rate cases, each of which was accepted by the Commission. ComEd argues that the MDS approach is an entirely theoretical, non-cost-based method for allocating costs. Through Mr. Heintz' testimony, ComEd points to the fact that the costs in distribution plant accounts 364 - 367, where not directly assigned, are properly allocated to customer classes, not individual customers, on non-coincident peak or coincident peak demands. The basis for allocating these costs among customer classes is straightforward: demands are the primary factor causing cost incurrence. Put another way, it is demand, not the existence of certain NESC safety rules, as IIEC witness Stowe asserts, which is the primary driver for the costs being allocated from FERC Accounts 364 -367.

ComEd contends it further showed that the failure to properly consider demand is precisely the reason why the Commission rejected the MDS proposal in its last rate case: "distribution systems are designed primarily to serve electric demand, and the Commission believes that attempts to separate the costs of connecting customers to the electric distribution system from the costs of serving their demand remain problematic." Docket 05-0597, Order at 165. ComEd argues that IIEC's MDS proposal does not resolve the problem the Commission identified. ComEd also notes that the same safety codes upon which IIEC now relies to support its MDS proposal also were in existence the last time the Commission rejected the MDS approach. Yet, ComEd states, IIEC assumes that the Commission was unaware of this fact the last time it rejected the MDS

approach. As such, demand remains the primary driver for these costs. ComEd concludes that there is no evidence in the record that would compel the Commission to reverse its view that the MDS approach is inappropriate for use in the ECOSS.

Average and Peak Methodology

ComEd urges the Commission to reject the City's proposal that the ECOSS include the A&P concept, noting that the Commission has rejected similar A&P proposals for electric utilities on a number of occasions. See, e.g., Commonwealth Edison Co., Docket 05-0597 at 171-72 (July 26, 2006); Central Il. Light Co., Dockets 06-0070/0071/0072 (Consol.) Order at 164-65 (Nov. 21, 2006). Similar to the MDS concept discussed earlier, ComEd states that the A&P allocation method is based on a non-empirical theory, and is not justified by, or reliant upon, ComEd's booked, embedded costs. ComEd also notes that the City does not dispute this fact. In contrast, ComEd's ECOSS is not grounded on speculative and debatable allocation theories; it is grounded on the costs set forth in ComEd's books. ComEd Ex. 33.0 Corr. at 13-14. In past dockets, the Commission has refused to require changes in its ECOSS that are not supported by reference to ComEd's actual costs. ComEd also observes that, consistent with the "tug of war" between residential and nonresidential customers, various nonresidential customers also oppose the City's proposal to adopt the A&P approach, including the Commercial Group, IIEC and Kroger. For all of these reasons, ComEd urges the Commission to continue reject the A&P approach in this proceeding.

ComEd also points to inconsistencies between Mr. Bodmer's two pieces of testimony in this proceeding, his testimony on behalf of the City, and his testimony on behalf of REACT. ComEd states that the A&P method will shift costs away from residential customers to nonresidential customers. Meanwhile, ComEd notes that REACT says nothing about this improper shifting of costs to nonresidential customers, apparently to avoid criticizing its own witness.

Customer-Specific Cost of Service Study Recommendations

ComEd's states that its assignment of costs on the basis of delivery class attributes for all delivery classes remains the more practical and less costly method to employ in developing the assignment of costs in the ECOSS. ComEd further states that the Commission has historically relied on the use of such studies for setting rates for all customer classes. Moreover, the evidence demonstrates convincingly that individualized cost of service studies are an inordinately complex undertaking, and are impractical and inappropriate for a number of reasons. ComEd Ex. 32.0 Corr. at 17.

ComEd responds that CTA, Metra and REACT requests for specific cost studies should be rejected. ComEd notes that they fail to cite to even one instance where the Commission has embraced the use of customer-specific cost studies for the purpose of setting rates. ComEd then shows that the complexity of the undertaking can be illustrated using the two railroad customers as an example. While just two customers, ComEd shows that the CTA and Metra have over 70 individual, noncontiguous traction power locations served by ComEd distribution facilities. ComEd Ex. 32.0 Corr. at 17-18. Thus, ComEd would have to conduct more than 70 cost studies just for these two

customers. To accomplish this task, ComEd would have to identify each individual component of the distribution system providing service to that particular point of service, and determine the cost for each component part. Moreover, ComEd states that in addition to being required to determine the cost of the equipment being used, it would then be required to determine the operating and maintenance expenses associated with each of these facilities.

The proposal for customer-specific cost studies also ignores the fact that ComEd does not record its costs to provide distribution-related services in a manner that would enable it to directly assign the investment costs incurred to serve these customers. Given this fact, and the complexity and enormity of the exercise described above, ComEd states that it is unreasonable to conclude it would be able to directly assign to these customers the portion of the investment or operating and maintenance costs incurred to serve them from the wide-reaching distribution system. In sum, the record clearly supports ComEd's position that customer-specific cost studies would be a complex, time-consuming and costly exercise.

ComEd says that customer-specific cost studies are impractical and inappropriate. ComEd cites to the testimony of Mr. Heintz, who noted that costs to serve customers do not remain static. ComEd Ex. 33.0 at 4. For example, a cost assignment based upon a specific 30 year old transformer in place at a customer's premises becomes understated in the event the transformer is replaced and new costs are incurred. Likewise, operating and maintenance expenses for an individual customer in any group can vary dramatically from customer to customer. In short, even if specific cost studies could be reasonably accomplished for these customers, intra-class subsidies would remain. And, inevitably, one or more customers are going to object to the result of these studies, resulting in the Commission possibly having to adjudicate the reasonableness of multiple studies instead of just an ECOSS.

The City's Street Lighting Proposal

ComEd asserts it also refuted the City's claims that the ECOSS must be revamped because it contains incorrect assumptions and contains numerous errors. ComEd shows that the information upon which the City relies is incorrect.

ComEd argues that the underpinning of the City's proposal is Mr. Bodmer's incorrect assumption that the City owns all the poles and secondary lines for its dusk to dawn street lighting system. Mr. Alongi and Dr. Jones demonstrate that thousands of City street lights are mounted on thousands of ComEd poles and are served by many miles of ComEd secondary lines throughout the City's alleys. ComEd Ex. 37.0 Corr. at 18. ComEd also notes that the City did not respond to this fact in its rebuttal testimony. ComEd incurs substantial costs in providing street lighting service to the City, as reflected in the ECOSS, and the City has provided no credible evidence which warrants an audit of the costs of providing street lighting service.

City ECOSS Issues

ComEd responds to the City's proposed adjustments to the ECOSS. ComEd argues that the City's proposals, all of which relate to residential customers, suffer from a variety of errors and incorrect assumptions and each should be rejected. ComEd also

notes that no other residential consumer advocate supports the City's proposals, and neither does Staff. ComEd claims the City witness Mr. Bodmer made a number of erroneous claims concerning the manner in which ComEd allocates costs between single and multi family residential customers, each of which should be rejected. ComEd argued:

- The City claims that far more multi-family customers live in the City. ComEd panel witnesses Mr. Alongi and Dr. Jones allegedly demonstrates that this claim is false. ComEd asserts that when all multi-family customers are properly considered, the facts show that 53% reside in the City and 47% reside outside of the City. ComEd Ex. 32.0 Corr. at 30.

- The City claims that residential customers in the City are more efficient because they use less electricity. ComEd demonstrates that this claim is baseless. ComEd panel witnesses Mr. Alongi and Dr. Jones notes that a household that uses less electricity than another household does not necessarily mean that the household uses electricity more efficiently. Factors impacting efficiency include: (1) the number of people in a household; (2) the number, use and efficiency of appliances and electronic equipment; and (3) the time at which electricity is used. *Id.* Mr. Bodmer concedes this point during cross-examination, admitting that he meant lower usage, not efficiency.

- The City claims that residential customers in the City use "far less" electricity than similar customers outside the City. Again, ComEd says this claim is incorrect. ComEd demonstrates that the usage of multi-family customers, regardless of location, is remarkably similar. In fact, those City multi-family customers with space heat use, on average, 18% more electricity than similar non-City customers. *Id.* at 31.

- The City equates low-use customers with low-income customers. ComEd asserts that this claim also was refuted through the panel testimony of Mr. Alongi and Dr. Jones. *Id.* at 24-26, 32-34.

In sum, ComEd asserts that none of Mr. Bodmer's proposals are reasonable or appropriate.

The City's Proposal To Allocate Costs Based On Regional Differences Must Be Rejected

ComEd urges the Commission to reject the City's proposal. ComEd responds to the City's proposal to allocate costs on regional differences stating that it is contrary to the facts. Through the panel testimony of Mr. Alongi and Dr. Jones, ComEd explains in detail why Mr. Bodmer's proposal is improper. ComEd Ex. 32.0 Corr. at 28-29. First, ComEd does not engineer its system based on the borders of local governmental entities. Moreover, Mr. Bodmer's proposal fails to recognize that most, if not all, counties that ComEd serves have areas experiencing either expansion or gentrification, which requires the installation of new distribution facilities. The City's proposal also fails to recognize that ComEd must maintain and replace older facilities in established areas of its territory. Because setting rates on a county-by-county basis does not allocate the actual costs of service any more directly or equitably than ComEd's proposal, the City's proposal should be rejected.

Rate Impact Analysis

ComEd states that it seeks to set distribution rates on traditional cost-causation principles to ensure that all customers are paying their fair share for distribution service. ComEd's goal in this proceeding is to reasonably apportion costs using the Commission's preferred embedded cost approach to minimize inter-class rate subsidies. ComEd shows that proposed rates are based on a valid and reasonable cost of service study, consistent with studies previously accepted by the Commission. Based on the ECOSS, ComEd proposes a 50% movement towards cost-based distribution facilities charges ("DFC") for the Extra Large Load, High Voltage and Railroad Delivery Classes rather than a 100% movement in order to mitigate the rate impact for these customers. ComEd states that the need to mitigate the rate impact to these customers results from the substantial rate subsidies these customers have received over many years. ComEd Ex. 30.0 at 43-45.

ComEd also cites to Kroger's brief, which states that fully cost-based rates for the over-10MW customers are "still lower, for the most part, than the rates of the non-residential classes that would be burdened with the subsidy" resulting from ComEd's mitigation proposal. Kroger Init. Br. at 8 (emphasis added). ComEd shows that all parties are keenly aware that the over-10MW customers have been receiving substantial subsidies for many years, including an annual subsidy of $44 million under current rates. ComEd states that this subsidy equates to those customers paying only 44% of their cost of service, and further claims that the record indicates that this point was recognized by the Commercial Group and Staff. ComEd Reply Br., at 118.

ComEd states that the evidence shows that such subsidies do exist, contrary to the claims of various large customers. It states that subsidies for the over-10MW customers have existed since the resolution of ComEd's rate case in Docket 01-0423. ComEd argues that all ECOSS studies in evidence in this case show the Medium, Large, and Very Large classes providing returns substantially above cost. Thus, there is no dispute that these classes are subsidizing the rest of the system. ComEd states that the reason for the differences in the percentage increase between large customers and the remaining nonresidential customers is simple: movement towards fully cost-based rates eliminates the subsidies that these large customers have been enjoying for years. Had these customers been paying cost-based rates, their percentage increases would be comparable to other nonresidential customers.

Interclass Allocation Issues

Interclass allocation concerns the allocation of the revenue requirement among customer classes and rate elements. This process is a zero-sum game, with the goal of allocating the revenue requirement among customer classes in a manner that is fair to customers, while allowing for full recovery of revenues. In making decisions concerning interclass revenue allocation and rate design, ComEd must balance the interests of all customers, not just those who are likely to participate in the rate case proceeding. If one customer class does not pay its fair share of costs, another customer class must pick up the bill, which creates subsidies. As such, ComEd states that its proposed rates limit such subsidies, while recognizing the need to mitigate rate increases for the Extra Large, High Voltage and Railroad Customer Classes. ComEd Ex. 300 at 43.

Across-the-Board Increase

ComEd contends that its revised rate design, including its mitigation proposal for the three largest nonresidential classes, is more appropriate and reasonable than an across-the-board increase. ComEd first argues that it demonstrated that if the Commission were to accept an across-the-board allocation proposal, new subsidies will be created by transferring more than $30 million dollars from the residential class to the nonresidential class. ComEd ex. 30.0 at 50-51; ComEd Ex. 43.0 Corr. at 32. ComEd next states that an across-the-board increase will continue to exacerbate existing subsidies to its three largest customer classes, which will make cost-based rate setting in future proceedings even more difficult and heighten the conflict between rate classes. In contrast, ComEd asserts that its rate design proposal is consistent with the Commission's long-standing goal of moving rates toward costs.

Finally, ComEd's proposed rates address rate impact concerns by gradually moving the largest nonresidential customers to cost-based rates. For these reasons, ComEd urges the Commission to reject an across-the-board increase both on the basis of cost justification and on the principle that fairness is more likely to be achieved when an objective standard, such as an ECOSS, is used to set rates. ComEd Init. Br. at 99-100.

ComEd claims that DOE, IIEC, REACT, CTA and Metra each support an across-the-board allocation approach in an attempt to retain rate subsidies currently borne by other nonresidential customers. Meanwhile, Staff supports an across-the-board increase premised on the errant belief that, in this instance, it is "equitable" to do so. Adoption of an across-the-board allocation would not be neutral to customers. Such an allocation is unfair to certain customers and contrary to the Commission's long-standing application of cost-causation principles. ComEd points out that Staff admits this last point in its Initial Brief, stating that this method: is an alternative to using a cost of service study and revenue allocation to determine rates. If the Commission adopts an across-the-board increase … the result would be to bypass the cost of service study and revenue allocation process. Staff Init. Br. at 96.

ComEd Response to Large Customer Claims

The large customers' claims supporting the use of an across-the-board allocation method rests on one incorrect claim: that the ECOSS is so flawed that it cannot be used to set rates. ComEd argues that this assertion is false, citing to its own testimony, as well as the positions of the Commercial Group, AG and Staff, which find the ECOSS appropriate for setting rates. ComEd further states that the record refutes the larger customers' claims that Staff found the ECOSS questionable. ComEd cites to Staff's Init. Br., which states that it is not a sufficient deficiency to make ComEd's cost of service study an unsuitable foundation for setting rates. It should be remembered that the Commission accepted ComEd's proposed cost of service in Docket 05-0597 without the distinctions between primary and secondary distribution costs advocated by IIEC. Thus, the Commission may not consider this failure to distinguish between primary and secondary costs sufficient reason to reject the Company's study as a ratemaking tool. Staff Init. Br. at 100 (citation omitted).

In fact, ComEd notes that Staff's support of the across-the-board approach has nothing to do with the validity of the cost study. Given that the ECOSS is reasonable, ComEd objects to Staff's proposal to use an across-the-board allocation method for setting rates, which is founded on Staff's concern about "bill impacts." ComEd also expresses surprise that Staff does not limit its proposal to only this case, but instead leaves it as the preferred approach for an indefinite period of time stating:

> [u]ntil some degree of rate stability returns, the design of ComEd rates should be based on bill impacts rather than cost of service. Staff Init. Br. at 99.

ComEd claims that adopting Staff's equal percentage across-the-board approach is not neutral to customers. In fact, it will harm certain customers. ComEd Reply Br. at 122. This approach will result not only in the continuation of rate subsidies for customers in the Extra Large, High Voltage and Railroad Customer Classes, it will exacerbate those subsidies. Moreover, this approach will create new subsidies, shifting approximately $33 million from the residential sector to small and medium nonresidential and street lighting customers. ComEd states that Staff's proposal would harm certain customers, subjecting them to increases that exceed the increase in the costs to serve them. See Alongi/Jones Sur. ComEd Ex. 45.0 at 9. ComEd notes that this result would, and has, created the "feelings of unfairness" that Staff was seeking to avoid, citing to the briefs of the Commercial Group and Kroger, neither of which wish to continue paying for existing subsidies, or start paying for new subsidies. Given that Staff seeks to impose this methodology indefinitely, those subsidies will continue to grow, making it even more difficult to move all customers to fully cost-based rates in the future.

Rate Moderation/Mitigation Proposals

ComEd's proposed rates incorporate a rate moderation proposal for the Extra Large, High Voltage and Railroad Customer Classes. ComEd states that its proposal is cost-based, using ComEd's proposed ECOSS, and moves these customer classes closer to cost. ComEd Ex. 32.0 at 9. This proposal also serves to reduce the size of the subsidy being borne by other nonresidential customers. Finally, ComEd states that its proposal also is consistent with the Commission's long-standing policy of setting rates based on cost. In short, ComEd concludes that the evidence supports using ComEd's rate moderation proposal to set rates.

ComEd recognizes that certain parties propose rate design alternatives based on cost, as alternatives to setting rates on a non-cost-based across-the-board allocation approach. Indeed, IIEC and DOE offer cost-based rate design proposals. ComEd also notes that Staff identifies ComEd's rate proposal as a viable alternative should the Commission seek to base rates on cost. While not ideal, ComEd submits that IIEC's and DOE's alternative proposals are a step in the right direction, as they are cost-based and move the Extra Large, High Voltage and Railroad Customer Classes towards a fully cost-based rate. In the end, ComEd states that setting rates on a cost-based rationale is far superior to the across-the-board allocation approach.

Meanwhile, ComEd also notes that there are various parties who reject any cost-based rate moderation/mitigation proposal. ComEd divides these parties into two camps: (1) those who do not want to continue to subsidize the rates of other customers (Commercial Group and Kroger); and (2) those who are interested only in maintaining their existing subsidies (REACT, CTA and Metra). ComEd states that it is sympathetic with the concerns of the Commercial Group and Kroger, which is why ComEd supports moving the Extra Large, High Voltage and Railroad Customer Classes rates towards costs. While not perfect, ComEd asserts that its rate proposal is preferable to the across-the-board allocation method. Meanwhile, ComEd states that there is absolutely no basis to support those parties only interested in maintaining or increasing their level of rate subsidization. ComEd Reply Br. at 123-24.

ComEd also urges the Commission to reject Staff's alternative proposal to average the distribution facility charge (DFC) for Medium Load, Large Load, Very Large Load, Extra Large Load and High Voltage (Other) customers so that each would pay the same DFC per kW of demand, $5.85. ComEd Reply Br. at 124. Under the updated ECOSS, it no longer makes sense to have a weighted DFC that includes the subclass of the High Voltage Delivery Class for customers with demand at or below 10,000 kW. Indeed, ComEd states that the bill impacts for these customers under Staff's proposal would be far greater than under ComEd's rate moderation proposal.

Finally, ComEd opposes the CTA's and Metra's alternative rate proposal. ComEd states that it is not cost-based, and seeks only to maintain existing rate subsidies.

Supply vs. Delivery Services Allocation Issues

ComEd states that REACT's proposal to carve out $64.9 million of so-called "Customer Care" costs from ComEd's delivery service rates and reallocate these costs to ComEd's supply rates is improper and unsupported. ComEd states that REACT's request should be rejected for four reasons. First, it is inconsistent with prior Commission Orders. Second, the adjustment is based on assumptions, not evidence. Third, as a matter of policy, the adjustment will unfairly penalize customers that decide to take supply from ComEd. Finally, REACT's rhetoric regarding retail competition is entirely contrary to the record. ComEd Reply Br. at 125.

ComEd first points out that REACT's proposal directly conflicts with recent Commission decisions. In this regard, ComEd cites to the recent Commission Order involving ComEd's proposed procurement plan and related supply tariffs. *See, Commonwealth Edison Co., Dockets 07-0528/07-0531 (Cons.) (Dec. 19, 2007).* In that proceeding, rather than being concerned that its supply rate was too low, as REACT suggests, Staff expressed concern that ComEd's proposed procurement tariff would create an inappropriate incentive to inflate the supply rate. Staff argued that ComEd's proposed procurement tariff would allow for the improper recovery of administrative costs through proposed Rider PE, which would be inconsistent with Section 16-111.5(l) of the Act. *Id.*; *Docket 07-0531, Staff Reply Comments at 11*. Staff argued to limit the scope of the supply tariff, Rider PE, to recover only those administrative costs that directly result from ComEd's discharge of its supply responsibilities, but not common costs that might otherwise be allocable to supply.

In response to Staff's concerns, ComEd amended its proposed tariffs, stating:

> …ComEd makes clear that the internal and administrative costs that will flow through the rider are those incurred solely as a result of ComEd meeting its statutory obligation. For example, ComEd would not recover in the rider either the costs of employees who are not devoted to procurement functions or allocated overhead costs. *Docket 07-0531, ComEd Reply Comments at 10* (emphasis added).

The Commission approved the revised proposed tariffs with these limitations. Docket 07-0528/07-0531 (Cons.), Order at 105 (Dec. 19, 2007). As such, contrary to REACT's claims, the facts demonstrate that Staff and the Commission have been concerned with the negative effects of inflating ComEd's supply rate. Moreover, REACT's attempt to flow these so-called Customer Care costs through Rider PE is in direct conflict with the concerns of Staff and the decision of the Commission. ComEd states that the Commission, having decided this issue only a few months ago, should not now reverse course and allocate these costs to supply rates based on faulty assumptions, which have no demonstrated relationship to ComEd.

ComEd points out that the recently decided procurement dockets were not the first time that the Commission considered the proper allocation of administrative costs as between ComEd's delivery service and supply rates. In ComEd's last rate case, the Commission also addressed an almost identical proposal to that now asserted by REACT. There, the Commission expressly rejected arguments "to allocate no less than one-fourth of call center costs to supply." Docket 05-0597 Order at 257. Moreover, in yet another prior rate case, the Commission approved ComEd's allocation of delivery-related expenses to delivery rates, which allocated these so-called Customer Care costs to delivery service rates. Docket 01-0423 Interim Order at 62-63; Final Order at 71-72. ComEd states that REACT has presented nothing that would support this abrupt reversal of prior orders.

ComEd argues that REACT's proposal rests solely on a series of arbitrary assumptions. REACT witness Merola assumes that supply-related costs must be included in delivery service rates because of his experience in examining other out-of-state utilities. REACT fails to explain the methodology used, or the approach taken in those states, to determine the existence of such supply-related costs. Furthermore, ComEd states that REACT fails to explain how Mr. Merola's methodologies or approaches might be applicable to ComEd. ComEd Reply Br. at 128-30.

ComEd then states that once Mr. Merola assumes that supply-related Customer Care costs must exist in delivery rates, his analysis then arrives at his 40% allocation figure based upon a series of additional assumptions, as he admits during cross-examination. Merola, Tr. at 1899-1906. ComEd argues that these assumptions have no relation to ComEd's actual Customer Care costs. Moreover, small variations in his assumptions can lead to dramatic fluctuations in results with respect to his proposed re-allocation percentage. In this regard, ComEd points to testimony that in testing the sensitivity of the result to Mr. Merola's assumptions, one modest adjustment to his assumptions would reduce the proposed adjustment from $64.9 million to $19.5 million. Tr. at 1905-07. In short, ComEd demonstrates that REACT asks the Commission to re-

allocate $64.9 million in costs to the supply function based upon myriad assumptions, none of which have been shown to be applicable to ComEd.

ComEd asserts that REACT fails to prove that any Customer Care costs would be avoided if all customers served under Rate BES migrate to alternative suppliers. ComEd Reply Br. at 130. ComEd states that it would continue to incur these Customer Care costs to serve these customers as part of its delivery function, as they are not costs that vary with the amount of kilowatt hours supplied by ComEd. Allocating any of ComEd's costs to supply should be limited to those costs that actually are reduced when ComEd no longer provides supply to customers. Energy losses and supply-related uncollectible costs are prime examples of costs that already are assigned to supply, because they are costs that ComEd no longer incurs when a customer chooses to take supply from an alternative supplier. As another example, ComEd has allocated a portion of Customer Records and Collection Expense (Account 903), $112,483, to its supply function. Meanwhile, allocating costs to supply, when those costs do not change as customers leave ComEd's supply, only serves to arbitrarily increase the supply price and distort appropriate price signals.

ComEd next demonstrates that REACT's proposal improperly seeks to shift costs away from those customers that elect to take supply from an alternative supplier to those customers that are eligible and choose to stay with ComEd supply under Rate BES (*i.e.*, residential and small commercial customers). ComEd Reply Br. at 130. It claims that this will result in those residential and small commercial customers that choose to stay with ComEd bearing an ever-increasing burden. In this regard, ComEd shows that it would be required to recover the $64.9 million in these Customer Care costs through its supply rate, from an ever-decreasing number of residential and small commercial customers as switching occurs. ComEd further notes that such a decrease in customers will occur, as the 100-400 kW nonresidential class to which service has been declared competitive, the grandfathering of which expires in May 2010, will no longer be able to obtain fixed price supply from ComEd. This, of course, will lead to the remaining customers electing to take supply from ComEd bearing a larger portion of the $64.9 million. ComEd states that such a result is unreasonable given that the costs REACT seeks to reallocate are, in fact, incurred, regardless of whether a customer switches to an alternative energy supplier.

ComEd next urges the Commission to reject REACT's claims concerning alleged competitive issues. ComEd Reply Br. at 131. ComEd states that REACT's claims regarding ComEd's "incentive" to inhibit the development of retail competition is incorrect. ComEd states that REACT's claims about Exelon Generation (ExGen) are contrary to the fact, pointing out that under current rates, it is likely that ExGen would rather sell its power at today's market prices, rather than the prices under which it currently sells power to ComEd. REACT's position ignores the fact that ComEd makes no profit on the sale of the commodity, yet remains at risk to supply and recovers its costs from bundled customers. Indeed, ComEd has precisely the opposite incentive from that resulting from REACT's hypothetical: ComEd has the incentive to have fewer bundled customers in order to reduce its risks. ComEd states that REACT's claims are an attempt to divert the Commission's attention from the real reason it proposes this

reallocation of delivery costs to supply: to improperly inflate ComEd's bundled supply prices for its own gain.

In the event the Commission concludes that REACT's re-allocation proposal should be adopted, ComEd asks that the Commission's Order in this proceeding should provide for certain conforming changes. ComEd Reply Br. at 133. First, the Commission should make clear that, notwithstanding any language to the contrary in prior Orders or in current tariffs, ComEd can make the appropriate filings to recover these costs immediately through Rider PE. Second, the Commission's Order should also include a finding that the Customer Care costs being re-allocated are just and reasonable. ComEd states that no party to this proceeding has claimed otherwise, or claimed that such costs are unrecoverable. Accordingly, consistent with Section 16.111.5(l), the Commission should find that these costs are "just and reasonable costs that the utility incurs in arranging and providing for the supply of electric power and energy." 220 ILCS 5/16-111.5(l). Finally, the Commission's Order should direct that ComEd remove the costs to be reallocated to supply from the appropriate delivery service classes in accordance with REACT's Ex. 7.1. ComEd states that these provisions are necessary in order to ensure proper recovery of its just and reasonable costs in a timely fashion.

B. IIEC

Overview

IIEC challenges the validity of ComEd's COSS in this proceeding. IIEC says problems with ComEd's study are evident from ComEd's proposed rates for large customers, which are illogical on their face. IIEC opines these proposed rates represent high rate increases over current rates, which were deemed just and reasonable by the Commission barely two years ago. IIEC also points out ComEd's rates are dramatically higher than those approved for large customers of other Illinois utilities without any readily apparent cost justification, and fails to reflect long standing rate relationships, class customer demands, and service voltage levels according to IIEC. These discrepancies and irrational study results led IIEC to review ComEd's COSS in detail. IIEC claims that review found numerous errors and flaws in ComEd's COSS that make use of ComEd's study for setting rates in this case inappropriate. IIEC points out that prior ComEd studies have had limited use in establishing delivery rates, and have not been used at all for the large customers within IIEC, since the original cost study used in 1999, and thus argues that any claim of precedent by ComEd is of little import.

IIEC argues that if the Commission approves the use of a COSS for revenue allocation and rate design purposes in this case, it should only approve the modified version of ComEd's study offered by IIEC.

IIEC argues that absent those corrections and modifications, the Commission cannot accurately determine, using ComEd's flawed COSS, the level of costs imposed by each customer class, and thus, the extent of any cross subsidies. IIEC concludes that without a sound basis for differential increases to various customer classes, that is a valid cost study, the Commission should approve an across-the-board increase so

that each customer class receives an increase in proportion to the overall increase in ComEd's revenue requirement.

IIEC says cost of service is a basic and fundamental concept in the ratemaking process and that its most important underlying tenet is the cost-causation principle. See Stowe IIEC Ex. 3.0-C at 4:49-52. IIEC states that the initial step in a COSS is to distinguish costs according to major functions (*i.e.*, transmission, distribution and customer) and, when needed, sub-functions such as primary and secondary voltage distribution lines, services, and line transformer costs, etc.

Primary customers benefit from the utility's primary distribution system, sub-transmission and transmission systems, customer service functions, etc., but do not use or receive any benefit from the secondary distribution system, *i.e.*, the part of the system operated at lower voltages. A properly done cost study minimizes the possibility that the primary customers could be allocated secondary system costs. The next step in a properly performed cost study is to classify the functionalized costs based on cost-causation principles, on the basis of whether they vary with the quantity of energy consumed, the peak electrical demand, the number of customers served, or some combination of these three classifications.

IIEC says the third step in the COSS is to assign or allocate functionalized and classified costs to each class of customers, using factors that are consistent with the causes identified in the second or classification step of the study.

IIEC argues ComEd's COSS does not properly distinguish its cost of service and therefore, fails to provide these benefits. IIEC also says that it produces rates and results that are not reasonable or logical and is not appropriate for use in revenue allocation and rate design in this case. According to IIEC, unless ComEd's study is modified as proposed by IIEC, there is no valid COSS in this case.

IIEC claims that ComEd has four non-railroad customer classes for customers with demands greater than 1 megawatt. IIEC points out ComEd originally proposed a system average increase of 21% in its overall revenue requirement, but that under ComEd's rate design in its direct case, IIEC says three of the large customer classes would have received delivery service rate increases ranging from 121% to 225%. One class would receive an increase of more than ten times the system average increase and two classes with demands of more than 10 MW would have received increases that exceed the dramatic increases proposed by ComEd for these customers in the last ComEd delivery service case, which were rejected by the Commission according to IIEC. In its rebuttal case, ComEd partially corrects its Rebuttal COSS. ComEd's Rebuttal COSS and rate design produces increases for the Extra Large Load Class, the High Voltage - below 10 MW Class, the High Voltage - over 10 MW Class of 142%, 124%, and 94% respectively, absent any mitigation.

IIEC says these increases are excessive, and the rates themselves are illogical. IIEC claims that without explanation, ComEd's proposed rate structure reverses rate relationships that have existed in ComEd's rates in every ComEd delivery service tariff approved to date. IIEC says ComEd corrected this particular anomaly in its rebuttal testimony, but did not correct the others. IIEC claims, for example, that ComEd's

original rates contained a higher DFC for standard voltage customers with demands greater than 10 MW than they do for customers with demands below 10 MW ($6.01/kW v. $5.76/kW). IIEC argues this represents a reversal of a rate relationship that has existed since ComEd first initiated delivery service, and which ComEd has maintained reflected its cost of service.

IIEC opines that ComEd argues in its very first delivery service case, in Docket 99-0117, that its proposed rate classes were based on size and had a high correlation between the voltage levels at which customers were served and that, in some cases, they correlated perfectly with those voltage levels. Docket 99-0117 Order at 50 (August 26, 1999). The Commission accepted this argument and in addition, determined that ComEd's rates properly assigned costs in accordance with the principles of cost causation and were just and reasonable. In the delivery service case in Docket 01-0423, IIEC states ComEd argued that it was more costly to serve customers below 69 kV than it was to serve customers at or above 69 kV, demonstrating that even in ComEd's opinion, higher voltage customers are less costly to serve. Docket 01-0423 Order at 152 (March 28, 2003).

IIEC says that ComEd's claim that the Commission expressly created specific interclass subsidies in the last case is incorrect. According to IIEC, the anomalies in ComEd's rate structure are not a function of specific subsidies created by the Commission. ComEd's claim is refuted by the language of the Commission's order in ComEd's last delivery service rate case, Docket 05-0597, where the Commission stated it was "... persuaded that the cost of serving very large customers is potentially lower than serving significantly smaller customers." Docket 05-0597, Order at 196 (July 26, 2006.

IIEC says the validity of ComEd's COSS and its claims of subsidies for large customers are also called into question by a comparison of ComEd's rates for its over 10 MW customers to those of other Illinois utilities providing delivery service to customers of a similar size. The differences in these charges are not simply due to it being more expensive for ComEd to provide delivery service than it is for the three Ameren companies, showing that ComEd's revenue requirement on a per kWh of electricity delivered basis, in comparison to the requirement per kWh of the three Ameren companies, demonstrates that ComEd's current unit cost of delivery service is within the range of those three utilities.

IIEC says the ComEd COSS closest in time to the proposed COSS in this case is the COSS presented by ComEd in Docket 05-0597. However, according to IIEC, that COSS was not used for setting rates for large customers. Docket 05-0597 Order at 196 (July 26, 2006). IIEC claims in Docket 01-0423, the ComEd COSS was not used at all to allocate revenues to the various subclasses within the non-residential customer class. Instead, the Commission approved an across-the-board rate increase proposal. Docket 01-0423 Order at 137 (March 28, 2003). IIEC states only in ComEd's original delivery service case, Docket 99-0117, did the Commission use the Company's embedded COSS to allocate revenue requirements among the non-residential delivery service classes. Docket 99-0117 Order at 58 (August 26, 1999("1999 Order")). The rate classes for large non-residential customers were defined differently, with customers

taking service at high voltages being included with other classes, and receiving a credit for services at high voltage. (See 1999 Order at 49-50). IIEC says that given the Commission's somewhat limited use of ComEd's prior cost studies, their use does not validate ComEd's more expansive use of a similar study in this case.

IIEC says inspection of the Company's COSS reveals that it contains several serious flaws that are inconsistent with cost causation principles. First, IIEC claims the Company's COSS cannot identify or separate primary and secondary distribution system costs and, therefore, assigns over $88 million in costs, incurred to install, operate, and maintain equipment used to provide service at secondary voltages, to customers taking service at primary voltages. Second, IIEC opines that because the COSS does not recognize the costs imposed by safety and reliability standards, such as the NESC, which are customer-related, additional millions of dollars of customer-related plant and O&M costs are improperly assigned to its rate classes on the basis of demand. Third, IIEC claims because the Company's COSS improperly allocates costs to customers taking services at voltages above 69 kV, it assigns costs incurred to install, operate, and maintain equipment, operating below 69 kV to customers taking service at or above 69 kV.

In rebuttal, ComEd claims it had revised downward the 69 kV allocator to the high voltage class to reduce distribution costs assigned to that class. However, IIEC says ComEd never explained, discussed or supported its adjustment with any supporting evidence. Therefore, IIEC argues the parties and the Commission cannot verify that ComEd's adjustment fully and correctly remedied the flaw in its study.

IIEC argues ComEd's study produces rates which are illogical, contain several flaws and should not be used in setting rates and allocating revenue responsibility in this case. IIEC recommends if the Commission wishes to use a cost of service study in this case, it should use IIEC's modified study. If the Commission determines there is no valid cost of service study for use in setting rates and allocating revenues in this case, then the Commission should adopt an across-the-board revenue allocation.

Primary/Secondary Split

IIEC says ComEd's COSS allocates secondary distribution system costs to customers who take service directly from the primary system. IIEC claims as a result, the study is not only unable to prevent the subsidization of secondary distribution costs by customers taking service from the primary system, it ensures such subsidies will occur. Separation of the primary and secondary system costs reduces the allocation of secondary distribution costs to primary customers by nearly $89 million. ComEd's failure to incorporate a primary/secondary split in its cost of service study has a significant impact on the customers.

ComEd initially took the position that it did not have the information to further identify the voltages of its distribution lines. Obviously ComEd should have sufficient information to perform a primary/secondary split.

IIEC reasons utilities do not always record gross plant and accumulated depreciation on their books in a way that makes the primary/secondary distinction obvious, but, FERC's requirement that the utilities record the "nature and amount" of

each expenditure and link them to a construction work order mandates the data be kept in a manner that allows utilities to identify costs associated with the primary and secondary distribution system components.

In summary, IIEC states ComEd's COSS fails to properly recognize a primary/secondary split in order to accurately reflect cost causation on the ComEd system. The COSS, as a result of the failure to include a primary/secondary split, creates and perpetuates subsidization of secondary costs by primary customers who receive no benefit from the secondary system. IIEC says contrary to ComEd's arguments, an appropriate analysis or study can be done using information that is already available to ComEd and with a reasonable investment of man-hours. Therefore, IIEC recommends the ComEd study should be modified to incorporate a primary/secondary split. In the alternative, IIEC says ComEd should be directed to incorporate a primary/secondary split in its next delivery service rate case.

IIEC witness Stowe modifies the ComEd COSS to incorporate a primary/secondary split. His changes allow the COSS to separately identify and allocate primary and secondary distribution costs.

IIEC says costs could not be readily associated with a specific FERC account or could not be separated using the FERC account percentages. Mr. Stowe separated the subject costs into primary and secondary components using the ratio of the primary to secondary costs identified in the FERC accounts. Mr. Stowe uses data obtained in discovery to determine the primary and secondary percentages he specifies in the modified study. He identifies 75% of the cost reflected in FERC Accounts 364 and 365 as primary and 25% as secondary. For Accounts 366 and 367, he specifies 50% primary and 50% secondary. His modification of the ComEd COSS reduces or eliminates the problem of unfairly allocating secondary costs to primary customers and the resulting subsidies.

IIEC says adoption of Mr. Stowe's modifications to ComEd's cost study reduces by nearly $89 million the secondary costs misallocated to primary customers, who bear no responsibility for their incurrence. IIEC claims that while this modification will have a *de minimis* impact on the total revenue requirement of ComEd, it will significantly affect the revenues recovered from the individual customer classes.

Minimum Distribution System

IIEC says while it is true that cost causation is often directly related to electrical parameters like voltage level or peak demand, they are not the only cost causing factors that should have been considered in the ComEd COSS. The Company ignores the fact that there are delivery service costs that are directly attributable to mandated safety and reliability requirements for electric utility distribution facilities and that these costs do not vary with customer demand. Therefore, IIEC argues these costs should not be allocated on the same basis as demand-related distribution system costs. IIEC points out these costs represent the minimum cost incurred by ComEd to install that portion of the distribution system costs that do not vary with customer demand. According to IIEC they represent a cost associated with adding customers to the system. This minimum cost is associated with what is generally called the minimum distribution system ("MDS").

According to IIEC, the cost of the distribution system that ComEd must build simply to provide service to its customers, regardless of the electrical demand of those customers, is the cost of the MDS. The cost of the MDS is directly related to the number of customers on the Company's system. IIEC concludes the MDS is, therefore, properly classified as a customer cost and properly allocated among customer classes in proportion to the number of customers in each class.

IIEC says to provide service to a residential customer, a utility cannot install wires smaller than a certain mandated minimum size; nor can a utility hang wires below a certain height. IIEC claims these requirements are entirely independent of the customer's maximum peak demand or energy usage. The utility is required to abide by the safety and reliability standards contained in the NESC. Under those standards, even if the demand of an existing customer increases or decreases, the cost of meeting the NESC standards remains fixed. IIEC argues the cost of meeting the Code requirements for a customer with a peak demand of 3 kW is exactly the same as that for a customer with a peak demand of 100 kW. Similarly, IIEC says if a customer expands its electrical load from 3 kW to 100 kW, additional costs on the system above the MDS, if any, would properly be allocated based on demand.

The costs associated with the MDS vary in direct proportion to the number of customers. The components of the system that only just conform to these safety and reliability standards such as the NESC, comprise the MDS.

IIEC argues the Commission has adopted the NESC standards. IIEC says the Code contains the minimum facilities and construction standards necessary for the safety of the public and utility employees in the installation, operation or maintenance of electric supply and communication lines or their associated equipment. IIEC says ComEd's COSS assumes that the total cost of facilities installed to meet code requirements are demand related. IIEC states this is simply incorrect. Therefore, IIEC concludes the Company's study is in error because it violates basic cost causation principles.

IIEC claims the Company's allocation of these customer related costs on the basis of demand is also inconsistent with the way the Company allocates distribution costs in its day-to-day operations. IIEC argues ComEd has tariffs on file with the Commission that allow it, in particular circumstances, to distribute the cost of distribution components on a basis other than demand. IIEC reasons that obviously, at a very practical level, the Company has accepted that certain line extension costs should be distributed in a way that is reflective of the number of customers, not demand (or energy usage).

IIEC takes the position that in this case, the Company's COSS is not capable of allocating MDS costs to customer classes properly.

IIEC says Mr. Stowe's recommendation would improve the accuracy of the Company's study. IIEC recommends the Commission should reject the Company's study unless modified to incorporate the MDS adjustment. However, if the Commission determines that Mr. Stowe's specific MDS adjustment is inappropriate, it should direct the Company to perform a precise study that recognizes the impact of the minimum

safety and reliability standards on the cost of constructing and installing the utility's distribution system. IIEC argues the costs thus identified can help correct the wrong assumption made in the Company's COSS that the cost of the distribution system is exclusively demand related.

IIEC says AG witness Rubin argues that IIEC's MDS proposal should be rejected because IIEC witness Mr. Stowe has allegedly failed to justify the Commission's acceptance of the MDS approach and the Commission had rejected variations of that approach in the past.

Average and Peak Methodology

IIEC says City of Chicago witness Bodmer, correctly notes that ComEd's COSS assumes that all of ComEd's investment in its distribution system is exclusively demand related. IIEC claims Mr. Bodmer suggests that the Commission adopt the average and peak ("A&P") allocation method for the allocation of distribution costs because it considers both peak demand and energy usage (average demand). (See, Bodmer, City Ex. 1.0-C at 20:346-350 and 355-359). His proposed A&P allocator is fictitious. IIEC argues Mr. Bodmer did not demonstrate or show how costs of the distribution system are caused by or affected by average demand or energy usage.

IIEC argues the ability of the distribution system to deliver electrical energy and serve average demand of customers throughout the year does not influence its cost. IIEC surmises that it is unreasonable to conclude that average demand or energy influences distribution system costs. In IIEC's opinion, the factors influencing the cost of the system are the need to build a minimum system to serve the customer in accordance with NESC standards and the need to ensure that the system is constructed to meet the highest demand/peak demand requirements of the customers. IIEC says average demand and energy usage simply are not cost causative factors for delivery services.

IIEC says there is no evidentiary basis for accepting City witness Bodmer's recommendation in this case, even if the Commission agreed with the concept. Finally, IIEC notes the Commission has previously rejected the use of the A&P method in ComEd cases. Docket 05-0597 Order at 172 (July 26, 2006). It should do so again in this case.

Across-the-Board Increase

IIEC states that rates should be set based on interclass revenue allocation and other processes founded on a valid COSS, but that ComEd does not present a valid COSS. IIEC claims that virtually every party conducting any significant review of ComEd's COSS in this case identifies significant shortcomings in the ComEd study.

IIEC presents a COSS in this case that recognizes the difference between primary and secondary distribution system components in allocating costs and recognizes that a substantial portion of the ComEd distribution system is customer-related, and thus represents a significant improvement over ComEd's study, and is the closest thing to a valid study in the record in this case.

IIEC avers that, absent a valid COSS, the Commission has no basis to assume the existence of interclass, or intraclass subsidies and, thus, has no basis to make any revenue allocation in this case other than an across-the-board revenue allocation, and claims that even ComEd, AG and other witnesses agree. Therefore, if the Commission concludes that the Company's COSS should be rejected, then the Commission should approve an across-the-board increase in this case.

Therefore, IIEC, in the absence of a finding by the Commission that a valid COSS exists in this case, believes the Commission should approve an across-the-board increase.

Rate Moderation /Mitigation Proposals

IIEC provides a rate moderation proposal that it claims should be used for rate design and revenue allocation purposes, if the Commission determines that rates should be based on a valid COSS instead of on an across the board basis. Under IIEC's proposal, increases to the Distribution Facilities Charge (DFC) of any class would be limited to not more than 25 percentage points above the overall revenue increase approved in this case.

If the Commission approves an across-the-board increase, IIEC's rate moderation proposal would not be necessary because no customer class would receive an increase in its DFC greater than 25 percentage points above the system average increase. The IIEC approach is not limited to any particular customer class and provides guidance on movement to cost over time, while providing a more moderate level of increase for particular customer classes facing significant increases.

IIEC addresses Staff's two rate mitigation approaches in this proceeding. The first proposal is to reduce ComEd's recommended increase to Extra Large Load and High Voltage (other) customers. Staff recommends averaging the DFC for Medium Load, Large Load, Very Large Load, Extra Large Load, and High Voltage (Other) customers. Specifically, each of the customers in these classes would pay the same DFC of $5.85 per kW. Staff Ex. 6.0 at 9:139-149. IIEC opposes this initial Staff mitigation proposal. The proposal increases the DFC for the Extra Large class by 138% and the High Voltage (Other) class sees a 164% increase in its DFC. In IIEC's view, Staff's initial proposal can hardly be considered a viable rate mitigation approach under such circumstances. Furthermore, Staff's original approach is based upon the Company's COSS presented in its direct testimony. IIEC points out that ComEd modified its COSS in rebuttal, and therefore, with no supporting study, the Staff's averaging proposal is no longer valid.

Consistent with its overall position, IIEC recommends that Staff's across-the-board approach should be adopted in the absence of a finding by the Commission of a valid COSS in this proceeding.

C. REACT

Overview

REACT continues to oppose ComEd's proposal to recover its costs in a manner that would simultaneously impose a massive, disproportionate, unjustified rate increase upon ComEd's largest customers, while continuing to misallocate supply-related costs to stymie the development of competition for its smallest customers.

REACT states that ComEd's proposed misallocation of costs violates basic cost causation principles, forcing RESs' customers to foot part of ComEd's supply-related bill and placing RESs at a competitive disadvantage to ComEd. (See REACT Reply Br. at 10; REACT Ex. 7.0 at 4-5, Lines 83-105; see also Docket 99-0117 Order at 24 (Aug. 26, 1999). REACT argues that despite ComEd's rhetoric that it supports the development of competition for its residential and smallest customers, ComEd's actions appear clearly designed to ensure that it continues to provide supply to as many of those customers as possible.

REACT also fundamentally objects to the imposition of what it characterizes as an enormous rate hike for over-10 MW customers based on an allegedly faulty ECOSS, instead advocating the feasible alternative of individualized cost-of-service studies for the relatively few customers in the over-10 MW classes in order to calculate the aggregate cost of service for those customers.

As REACT points out, even under ComEd's "modified" proposal, which would simply "phase-in" the proposed increase, the largest of the 26 Extra Large High Voltage Customers eventually would receive more than a $900,000 annual rate increase; for the 53 Extra Large customers that are not served via high voltage, the annual impact of ComEd's proposal would range from approximately $420,000 at the "low" end to more than a $3.2 million increase – these proposed increases are per year, per customer. See REACT Ex. 5.0 at 2-3, Lines 25-40; ComEd Ex. 32.0 at 9, lines 137-46. REACT points with agreement to the DOE position that even ComEd's "mitigation" approach would constitute rate shock. See DOE Init. Br. at 14.

REACT notes that ComEd admits it "supports a substantial increase for its very largest customers," based on an alleged subsidization of the largest customers by medium-sized customers. ComEd Init. Br. at 9. REACT states, though, that the alleged subsidization to which ComEd refers has been seriously called into question by numerous parties.

REACT concludes that it appears largely uncontested that ComEd's proposed rate increase for the over-10 MW customers is (1) disproportionate; (2) not derived from a change in delivery services usage or a valid cost study; and (3) not based upon a rationale basis for cost allocation.

Embedded Cost of Service Study Issues

The ECOSS suggests a massive increase for the over-10 MW customers – 129.4% and 140.4% – that is inconsistent with the overall requested rate increase –

21%. REACT argues that these results would suggest either that there are subsidies in ComEd's current rates or that the over-10 MW customers have done something to change their usage that would justify an increase. ComEd's President acknowledged that ComEd's current rates do not contain cross-subsidies, and ComEd has admitted that the over-10 MW customers "didn't do anything" to justify the increase.

REACT points out that the application of the ECOSS as a basis to justify ComEd's proposed rate increase has been seriously questioned in the instant proceeding. Among the ECOSS's problems are: (1) including the cost of secondary wire in the cost for the over-10 MW ratepayers; (2) including the cost of distribution lines in the high voltage class when many of the those ratepayers use no distribution lines whatsoever; (3) assuming that the age of the lines, the quantity of poles, and the spans of primary under-ground and overhead lines will be the same for over-10 MW ratepayers as other ratepayers if the non-coincident load is the same; and (4) assuming the cost of tree trimming, the cost of underground cable repairs, and other distribution line costs will be the same for over-10 MW ratepayers as other ratepayers if the load is the same.

REACT agrees with IIEC that the failure of ComEd's ECOSS to properly allocate secondary wire as illustrative of the substantial flaws in ComEd's cost study. ComEd admits a defect in the ECOSS and that a correction of that defect "would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage, or Railroad delivery classes." The Commission should not endorse ComEd's view because ComEd's view is totally at odds with the Act's requirement that ComEd bear the burden of proof to justify its proposed rate increase. See REACT Reply Br. at 16, citing 220 ILCS 5/9-201(c). If the ECOSS is faulty, as ComEd now admits, then the ECOSS should not be used as the basis for allocating the proposed rate increase.

Customer-Specific Cost-of-Service Study Recommendations

Several parties now favor some form of an individualized cost study for some or all over-10 MW customers. REACT argues that it would be reasonable to say that there is a consensus position among the particularly affected stakeholders on this general approach. ComEd maintains that an individualized cost-of-service study would be "impractical and inappropriate." ComEd Init. Br. at 96. Thus, according to REACT, ComEd continues to assert that the cost of such studies would outweigh the benefits, even though, as REACT notes, ComEd has not presented any specific evidence regarding the costs or the benefits. ComEd has not hired a single expert to evaluate the actual costs to serve the 79 over-10 MW customers, while it has hired many experts to defend the flawed ECOSS and advocate for ComEd's proposed higher overall revenue requirements.

REACT states that ComEd's implication that individual audits of its 79 largest customers would be unjustifiably expensive or impractical is ironic where ComEd itself has proposed to raise rates for these very customers by tens of millions of dollars per year based upon the faulty ECOSS. From a customer perspective, the costs and inconvenience associated with allowing ComEd to rely upon its flawed ECOSS study obviously dwarf the cost of requiring ComEd to perform audits for each of the 79 individual very large ratepayers.

REACT criticizes ComEd for allegedly failing to take issue with or attempt to rebut the basic points that REACT and other parties have made repeatedly throughout this proceeding in support of individualized cost studies for over-10 MW customers. Performing individualized cost-of-service studies is consistent with ComEd's stated desire to "move toward cost." The rate level ComEd proposes for its largest ratepayers is very high relative to the rates other utility companies charge their largest customers. ComEd's repeated assertion that the over-10 MW customers are being "subsidized," is contrary to the Commission's observations in prior cases, such as ICC Docket 05-0597. Individualized studies are consistent with the principle of avoiding cross subsidization.

The Commission should direct ComEd to measure the cost to serve the customers through audits of actual costs for each of the 79 customers, so as to evaluate rate levels relative to the depreciated cost that ComEd actually has on its books for equipment installed to serve each customer.

Rate Impact Analysis

REACT argues generally: (1) that ComEd's proposed rate increase is "rate shock"; (2) that ComEd fails to offer anything to guard against potential negative rippling economic effects; and (3) even ComEd's "mitigation" plan would constitute "rate shock."

The increases faced by over-10 MW customers are in percentage increases (140.4% and 129.4%) and in actual dollars ($420,000 to $3.2 million per year, per customer). Further, according to REACT, ComEd does not, and cannot dispute the fact that the increases faced by over-10 MW customers are grossly out of proportion to the much lower increases for other customer classes.

REACT argues that as a matter of Illinois law, the Commission is required to consider the impact of ComEd's proposal upon these customers. REACT cites *Abbott Laboratories, Inc. v. Illinois Commerce Comm'n,* 289 Ill. App. 3d 705, 716, 682 N.E.2d 340, 350 (1st Dist. 1997), which states:

> A determination of what is 'just and reasonable' involves a balancing by the Commission of the interests of the utilities' stockholders and the utilities' consumers. The Commission cannot fulfill its statutory duty to balance the competing interests of stockholders and ratepayers without taking into account the impact of proposed rates on ratepayers.

The rate impact that ComEd's proposed allocation of its rate increase would have upon its largest customers provides an independent basis for the Commission to reject ComEd's ECOSS.

REACT agrees with DOE that the impact of ComEd's "mitigation" plan, which still would result in massive, disproportionate rate increases for ComEd's largest customers, constitutes rate shock on any reasonable scale.

Interclass Allocation Issues

Across-The-Board Increase

The Commission should reject ComEd's ECOSS and simply limit the percent rate increase the over-10 MW classes receive to the overall system-wide average increase,

just as the Commission did in ComEd's last rate case. REACT argues that the across-the-board proposal or assigning a system-average increase is preferable to ComEd's "mitigation" proposal because ComEd's "mitigation" plan merely would delay imposition of the full brunt of the enormous rate increase that ComEd proposes for the over-10 MW customers.

Other Rate Moderation/Mitigation Proposals

ComEd contends that its proposed "mitigation" plan constitutes a "measured movement to cost" based on "tradition[al] cost-causation principles to ensure that all customers are paying their fair share for distribution services, or moving in that direction." ComEd Init. Br. at 101 [correction added]; REACT Reply Br. at 24. There is nothing "measured" about ComEd's proposal, which imposes a massive, disproportionate rate increase upon over-10 MW customers. REACT argues that in light of the evidence invalidating the ECOSS, particularly with regard to the over-10 MW customers, it is intellectually dishonest for ComEd to represent that it is actually moving away from alleged subsidies and toward cost. ComEd's President and CEO testify that no such subsidies exist. See Tr. at 108, Lines 3-9. Finally, approving ComEd's "mitigation" plan now would act as an "endorsement" for another massive rate increase in the future.

The Commission should recognize that ComEd's plan is merely an attempt to hide the glaring flaws in ComEd's ECOSS, and provide cover for ComEd to impose multiple massive rate increases upon its largest customers.

Supply vs. Delivery Services Allocation Issues

The portion of ComEd's Customer Care Costs associated with ComEd's supply function should be allocated to ComEd's supply rates, rather than included in ComEd's delivery services rates. REACT maintains that ComEd has improperly included more than $64.8 million of supply-related Customer Care Costs in its proposed delivery services rates.

REACT's Mr. Merola, a competitive energy markets analyst, concludes that there is no doubt that that certain Customer Care Costs that ComEd proposes to recover in its delivery services rates are related to supply rather than delivery services. REACT Init. Br. at 49-60. Mr. Merola explains that he would have anticipated that ComEd would have separately tracked these supply-related costs or proposed some allocation methodology of its own. Instead, ComEd makes the incredible assertion that none of the Customer Care Costs should be assigned to ComEd's supply function. (See REACT Ex. 7.0 at 19, Lines 416-27.)

Mr. Merola explains that one legitimate methodology that the Commission could use to allocate these Customer Care Costs would be to base the allocation upon the share of revenue associated with supply compared to the share of revenue associated with distribution. Clearly, supply represents a much higher percentage of a customer's bill than does distribution, and under that methodology the allocation factor would likely be in the range of 67%. Instead of applying such a rough allocator for these costs, Mr. Merola analyzes ComEd's proposed $162,150,019 Customer Care Cost revenue requirement for fixed-price bundled customers, and concludes that 40%, or

$64,860,008, of ComEd's Customer Care Costs should be allocated to the supply function. The allocation methodology that Mr. Merola uses was similar to the embedded cost methodology that ComEd has proposes for other cost allocation issues.

Finally, Mr. Merola investigates how other utilities that are providing service in competitive markets in other states calculate their supply administration costs, and concludes that the allocation of 40% of the Customer Care Cost to a bypassable supply charge would be fully in line with the treatment of this issue by the other similarly-situated utilities. He concludes that ComEd's supply-related charges are "far lower" than the supply administration rates set by the other utilities he examines, confirming his concern that ComEd's proposed recovery of supply-related administrative costs appears to be "artificially low." *Id.* at 26:540-42.

REACT observes that Mr. Merola's detailed analysis was much more comprehensive than any analysis that had previously been done in any prior rate case. See REACT Ex. 7.0 at 13-22, Lines 291-486; Tr. at 1349-53. REACT also notes that ComEd had the opportunity to develop actual data allocating Customer Care Costs between supply and delivery and to challenge Mr. Merola's allocations by providing allocation factors of its own. Instead ComEd chooses to stand by its original position that there is nothing to allocate. ComEd's position that it incurs zero supply-related Customer Care Costs cannot withstand scrutiny – particularly given its own witnesses' admissions. See Tr. at 282, Lines 6-15; Tr. at 1382-87; REACT Init. Br. at 50-56.

ComEd's argument that REACT has not proven that Customer Care Costs are "solely supply-related" misstates the appropriate test, and misses the point. REACT notes that it is a basic tenet of cost-of-service studies that costs solely related to one function should be directly assigned to that function, but costs related to multiple functions must be allocated between those functions.

ComEd points to no evidence that shows that 100% of the Customer Care Costs are caused by providing the distribution function. For example, Mr. Crumrine states that 'the Billing and Customer Support function exists regardless of whether or not a customer is a supply customer.' However, the question is not whether ComEd should provide these functions (or even whether to recover the costs associates with these functions.) Rather, the question is whether zero % of the associated costs are caused by the fact that ComEd is the supplier of energy. Staff supports REACT on this point.

REACT is not claiming that any of these functions is solely supply-related. REACT argues that some portion of these functions are supply-related, but not the sum total.

REACT observes that the Commercial Group and RESA also support REACT's position on the allocation of Customer Care Costs. ComEd's attempt to discount this cost allocation issue as an attempt to create "headroom" does not apply to the independent analysis and support of Staff, the Commercial Group, and RESA.

REACT rebuts ComEd's assertion that the definition of "delivery services" in the Act somehow precludes the Commission from properly allocating some supply-related costs to ComEd's supply function. REACT observes that a plain reading of the definition in the Act makes it clear that the definition does not prevent any category of

costs from being both a supply-related cost and a distribution-related cost. Indeed, ComEd even recognizes that some costs should be "functionalized" or allocated between the utility's transmission, distribution, and supply-related rates. Thus, ComEd admits that some Customer Care Costs should be allocated to the supply function; the appropriate inquiry for the Commission is not whether but rather how much of those Customer Care Costs should be allocated to supply. REACT submits that the answer to the inquiry is that at least $64.8 million of the costs ComEd allocates to delivery services should be allocated to supply.

According to REACT, competitive market issues are inextricably intertwined with the question of the proper setting of delivery services rates. Misallocating supply costs into delivery services rates affects the price of electricity in the competitive market. See generally Tr. at 2231-33; REACT Cr. Ex. 18. Specifically, artificially increasing delivery services charges means improperly lowering ComEd's supply-related charges to ComEd Rate BES customers. ComEd's proposal clearly inhibits the development of the competitive retail electric market.

REACT is also critical of ComEd's failure to specifically address in its Initial Brief the incentives that exist for ComEd to attempt to inhibit the development of retail competition: short-term revenues based upon inaccurate residential switching projections, and Exelon Generation is able to sell more supply to ComEd under the supplier forward contracts if ComEd suppresses competition for its residential and smallest commercial customers. See *id*. at 72-73.

REACT observes that in its Reply Brief ComEd improperly suggests that the supply vs. delivery services allocation issues were fully addressed in the proceeding approving Rider PE. See ComEd Reply Br. at 126-27. REACT suggests that if ComEd had put this position forward in its Initial Brief, REACT would have been able to respond that the Rider PE proceeding was a "rocket docket," which started in October and concluded less than two months later. There is no evidence that anyone raised any issue related to the allocation of Customer Care Costs in that proceeding. See generally, *id*.

ComEd does not deny that it has the ability to discourage customer choice by improperly allocating supply costs to its delivery services function. Second, ComEd is completely silent regarding its ability to reap short-term revenues based upon inaccurate residential switching projections. Most significantly, ComEd admits that given the right market conditions, its corporate parent Exelon does have an incentive to discourage its residential and smallest commercial customers from exercising choice; ComEd just maintains that those conditions did not exist at one point during the hearing. See ComEd Reply Br. at 132.

ComEd improperly allocated at least $64.8 million to its delivery services function, in an apparent attempt to discourage choice for its residential and smallest commercial customers.

Specifically, REACT believes that ComEd is misleading the Commission by suggesting in its Reply Brief that correct allocation of supply-related Customer Care Costs will eventually result in a "crushing burden" on non-switching customers. (ComEd

Reply Br. at 131.) ComEd's unfounded assumptions apparently are that the amount of Customer Care Costs and the accurate allocation of those costs will always remain the same. Of course, when that happens, ComEd can seek an adjustment in the allocation between supply-related and delivery services-related costs.

REACT submits that the Commission should be wary of allocations which should have no impact on the bottom line of ComEd, but may impact the profitability of Exelon.

D. Staff

Interclass Allocation Issues

Across-the-board increase

It is Staff's position that an equal percentage, across-the-board increase on existing rate elements represents the most reasonable approach to designing rates in this proceeding. This approach recognizes that all ComEd ratepayers have been financially stressed by significant increases in electricity costs that may very well continue for the foreseeable future. It is most equitable under these circumstances to apportion increases as equally as possible, which is the purpose of an across-the-board, equal percentage increase.

The across-the-board approach is reasonable because bill impacts have been and will continue to be an overriding concern for all ComEd ratepayers. These ratepayer concerns have recently led to a number of extraordinary steps. The Commission found it necessary to launch an investigation of ComEd's rates to address concerns raised by ComEd customers to members of the General Assembly and others. Illinois Commerce Comm'n. v. Commonwealth Edison Co., Docket 07-0166, Order Initiating Investigation at 2 (March 2, 2007). Furthermore, ComEd and its parent company, Exelon, were required to mitigate the impact of the recent rate increase through the offer of approximately $500 million in rebates to ComEd ratepayers.

Staff submits that bill impacts will remain a prominent concern in the future because ComEd customers are experiencing a steady stream of rate increases on various fronts. For example, ComEd recently completed a transmission rate case that features an increase of $93 million in the transmission revenue requirement as well as the inclusion of CWIP in rate base and a return on equity adder for a West Loop project. Power costs for bundled customers are set to increase on June 1 of this year, with the average bill increase for residential customers estimated by ComEd at approximately 2.5%. *Id.* at 19: 434-438.

In this docket, ComEd files for a rate increase of $361.3 million which, if accepted, would raise residential bills by almost 8% (absent the impact of the rate rebate). The Company also proposes in this docket to institute Rider SEA and Rider SMP that would allow recovery of additional revenues from ratepayers on a going-forward basis beyond the rate increase ultimately granted in this proceeding. For example, Rider SMP alone could increase delivery service bills by as much as 5% per year under the rate cap proposed by ComEd, while the Company presents no cap on the increases that would be permissible under Rider SEA. ICC Staff Exhibit 18.0 at 19-20:440-448.

Furthermore, the Company indicates that plans are afoot to seek further delivery service rate increases in the immediate future. Staff contends that the foregoing evidence indicates that ComEd ratepayers have and will continue to face upward rate pressure on a number of fronts and makes bill impacts an overriding concern for the foreseeable future.

An alternative approach that distributes these increases on an unequal percentage basis may create feelings of unfairness among ratepayers who receive above-average increases. *Id*. at 20-21:464-471.

The Commission should not permanently discard its cost of service standard on a going-forward basis. The Commission's goal of cost-based rates remains an important ratemaking objective that should continue to be pursued. However, the electricity industry in Illinois has undergone a difficult transition since the rate freeze expired on January 2, 2007. Until some degree of rate stability returns, the design of ComEd rates should be based on bill impacts rather than cost of service. *Id*. at 21:473-480.

The proposal for an across-the-board increase on existing rates was originally made by IIEC Witness Stephens for a number of reasons. It is Staff's position that the across-the-board approach is reasonable for the reasons discussed previously at the beginning of this Section, not necessarily for the reasons presented by IIEC in support of its proposal.

IIEC makes a reasonable argument that ComEd's cost study improperly allocates lower voltage costs to higher voltage customers. However, this is not in Staff's opinion a sufficient deficiency to make ComEd's cost of service study an unsuitable foundation for setting rates.

Illinois ratepayers are financially stressed by the increases in their electric bills. Both residential and business customers find it increasingly difficult to absorb the rising cost of electricity. Thus, bill impacts have become an overriding concern.

In this situation, it is not evident that any one group of customers can more easily absorb increases in delivery services costs than other customers. There is no evidence on the record to show that residential or business customers are more able to absorb disproportionate increases in these costs than others. Thus, the fairest approach which recognizes the difficulty faced by all is to give all customers the same percentage increase.

ComEd responds to the parties' proposals for an across the board increase by arguing that "[a] system average increase, however, does not reflect the costs customers impose on the system." *Id.* In ComEd's estimation, the acceptance of an across-the-board allocation proposal creates new subsidies that do not currently exist by shifting millions of dollars from the residential class to the nonresidential class. *Id.* In contrast, ComEd argues its revised rate design proposal is consistent with the Commission's long-standing goal of moving rates toward costs while addressing bill impacts concerns by gradually moving the largest nonresidential customers to cost-based rates. *Id*. at 100.

Staff responds that the Company's argument is reasonable if not for the unique and difficult circumstances surrounding this rate case. Ratepayers have absorbed numerous rate increases since the expiration of the statutory rate freeze as of January 2, 2007; and, as a result, bill impacts have emerged as the over-riding issue for electric ratemaking in Illinois. Staff presented in its Initial Brief a description of the rate increases ratepayers have experienced in the recent past and will likely experience in the near future. Staff IB, pp. 97-98. Staff also identifies the extraordinary steps taken by both the Commission and the Legislature to address these increases. *Id*. The importance of the bill impacts issue is evident.

Other Rate Moderation/Mitigation Proposals

If the Commission determines that some movement towards cost-based rates is appropriate in this proceeding, then Staff recommends we consider the proposal Staff made in direct testimony to reduce ComEd's proposed increase to Extra Large Load and High Voltage (Other) customers. That proposal entails averaging the Distribution Facilities Charge for Medium Load, Large Load, Very Large Load, Extra Large Load, and High Voltage (Other) customers so that each customer class pays the same $5.85 DFC per kW of demand. This process results in Medium Load and Very Large Load customers paying rates that are 2.48 percent and 1.41 percent above ComEd's proposed cost of service, respectively, but also reduces the proposed increase to High Voltage (Other) customers by 18.11 percent. Averaging ComEd's proposed DFC for Medium Load, Large Load, Very Large Load, Extra Large Load, and High Voltage (Other) customers also temper ComEd's proposed 140.4 percent increase in revenues from Extra Large Load customers by 2.72 percent. ICC Staff Ex. 6.0 at 9:136-149.

The Company for its part presents an alternative proposal that moves the distribution facilities charges for the Extra Large Load Delivery Class, and the under and over 10 MW High Voltage and Railroad Delivery Classes, half of the way toward cost of service. ComEd Ex. 30.0 at 50:1120-1123. This is another alternative to addressing bill impacts for large customers that the Commission could consider if it wishes to base rates on costs rather than adopting an across-the-board increase which Staff recommends.

Supply vs. Delivery Services Allocation Issues

Staff in its initial brief comments on the issue of allocating costs associated with billing, customer support, and credit and collections (referred to as "Customer Care Costs" by REACT).

Staff notes its concern with ComEd's statement that there is no evidence to suggest that any Customer Care Costs would be avoided "if all customers served under Rate BES migrated to alternative suppliers", while ComEd points to no evidence that shows that 100% of the Customer Care Costs are caused by providing the distribution function. Staff observes that the question is not whether ComEd should provide these functions (or even whether to recover the costs associated with these functions). Rather, the question is whether zero % of the associated costs are caused by the fact that ComEd is the supplier of energy.

Similarly, in response to ComEd testimony that “REACT has not adequately explained the basis for deeming any of these functions to be solely supply-related”, Staff observes that it appears that REACT is not claiming that any of these functions are solely supply-related. Rather, REACT seems to be arguing that some portion of these functions is supply-related, but not the sum total.

Staff also notes that REACT needs to better explain how their cost-causation argument is in line with the cost recovery of items that enable customer choice.

After reviewing the positions and arguments of parties in their initial briefs regarding the issue of allocating costs associated with billing, customer support, and credit and collections (“Customer Care Costs”), Staff acknowledges that some portion of Customer Care Costs might properly be allocated to the supply function because it appears intuitive that ComEd’s role as a supplier of energy in addition to providing the delivery function would have some impact on the level of these costs. Because the degree of such a potential impact is very difficult to discern at this point and because Staff did not address this issue in testimony, Staff offers no specific estimate for a potential allocation at this time. Staff further notes that the issue of supply-related costs generally was addressed in Dockets 07-0528/07-0531, Commonwealth Edison’s procurement plan and related tariffs.

E. DOE

The DOE contends that the ECOSS is not valid, therefore no rate allocation based on it should be ordered by the Commission. The ECOSS charges smaller customers far less than high voltage customers per kW even though the cost of providing that service is far less for the high voltage customer.

The ECOSS's failure to disaggregate distribution costs on the basis of different voltages at which customer classes take service causes it to attribute significant distribution facility costs to customer classes that do not "cause" them. The Company witness who prepared the study admits that it is “inevitable” that a cost of service study that fails to distinguish between primary and secondary voltage customers imposes costs of the secondary system on large customers who do not use that secondary system. This is the reason the COSS yields counter-intuitive cost allocations, unreasonable rates, and rate shock.

The DOE recommends that the Commission direct the Company to correct the COSS in its next distribution rate filing by breaking down the distribution system below 69 kV into two or possibly three voltage delivery levels: (1) at or above 12.5 kV and below 69 kV; (2) 2.3 kV up to 12.5 kV; (3) below 2300 volts.

The Company’s proposed distribution facilities charges and increases for the four largest customer classes* produce rate shock. The DOE urges the Commission to direct the Company to distribute any jurisdictional revenue increases on an equal percentage across the board basis. Alternatively, the Commission should phase in the rates in three 33% movement toward unit costs that the COSS implies, and separate out costs associated with serving High Voltage customers' standard voltage loads.

Adopting the COSS, together with any mitigation adjustment cannot, except by chance, move rates toward cost of service. In fact, no one knows what the Company's cost of service is.

F. City

Embedded Cost of Service Study Issues

First, the City contends that the cost study ignores important distinctions between the costs spent to serve multi-family customers versus the costs spent to serve single-family customers. Second, the City states that ComEd's ECOSS does not allocate costs that the utility states are largely driving its request for rate relief to the cost-causers – customers moving to "collar" and "far-collar" counties. Third, the City asserts that the cost study wrongly allocates certain costs based on the number of customers. The utility's chosen method is regressive and should be rejected. Fourth, the City claims that ComEd's cost study should allocate distribution costs using the average and peak ("A&P") method rather than the coincident peak ("CP") method utilized by the utility. Finally, the City asserts that ComEd's ECOSS ignores important cost differences in serving the City's street lighting account, differences that make the City's street lights cheaper to serve than street lights operated by other municipalities. To rectify this, the City recommends that ComEd be ordered to conduct and audit of the costs it incurs to serve City street lights.

According to the City, ComEd's cost study does not consider certain cost factors that have the effect of artificially inflating rates for multi-family residential customers. Such factors include failing to account for the difference between the percentage of underground lines serving multi-family customers versus the percentage of underground lines serving single-family customers, and the density of multi-family customers versus the density of single-family customers.

In prior cases, ComEd's marginal cost studies distinguished costs according to density and the extent of undergrounding. These studies sought to identify specific types of facilities used by different types of customers, and attempted to use actual engineering data rather than simple accounting formulas. In doing this, ComEd analyzed the costs of different types of equipment used by ratepayers in the individual rate classes. Once the study identified costs associated with typical ratepayers, it used coincident demand rather than non-coincident loads in aggregating the cost of most distribution equipment (other than secondary wires). Furthermore, costs that ComEd now asserts are entirely customer-related such as customer information and customer installation expenses, were not included in or allocated by the marginal cost-of-service study. Instead, because ComEd developed tariff components on the basis of an equal percentage of marginal cost, these costs were essentially allocated on a percentage of revenue basis. City Ex. 1 at 45-46, L. 828-40.

The City states that ComEd's ECOSS in this case made no such distinctions. The cost study in this case allocates the cost of distribution lines and transformers between multi-family and single-family customers based on each class's share of non-coincident peak load. *Id.* 47, L. 859-62.

ComEd dumps all distribution poles, all types of overhead distribution lines except service drops and all underground distribution conduit into this single account, which sums to $7.4 billion of plant – more than half of ComEd's plant balance. In terms of distribution revenue requirements, this "distribution lines" account comprises $921.6 million out of a total $2.049 billion – 45% of the total cost of service. Then, for this massive cost item that contains primary and secondary above- and below-ground wire as well as poles, ComEd simply allocates all of the cost to customer classes using the estimated size of customer classes. Because all costs for wire and poles are crammed into a single account, the allocation gives no consideration to the density characteristics of the customer class, the class's share of underground or overhead equipment and the timing of distribution facility construction. *Id*. at 30-31, L. 536-47.

Although multi-family customers represent only 4.7% of ComEd's energy sales, they are saddled with 10.6% of ComEd's cost of service. *Id*. at 48-49, L. 887-89, 891-92. Multi-family customers use only 4.7% of ComEd-supplied energy, but they bear 21% of customer costs. *Id*. at 49, L. 889-92.

City residential customers use far less electricity than non-City customers (346 kWh/mo. for City residents versus 553kWh/mo. for non-City residents – a difference of almost 60%). See *id*. at 7, Lines 114-23. The City claims that the import of these findings is that: (1) ComEd's ECOSS is especially pernicious to multi-family, low-use and often low-income customers because it would impose inappropriate costs on those customers least able to afford such costs; and (2) ComEd's cost study penalizes residential customers who use less energy. This contravenes legislation enacted by the General Assembly in 2007.

New legislation requires ComEd, the Ameren utilities and the Illinois Department of Commerce and Economic Opportunity to implement energy-efficiency and demand-response programs designed to reduce electricity usage. The General Assembly in Pub. Act 95-0481 § 1-5(4) (2007) stated that it is the policy of the State of Illinois that "investment in cost-effective energy efficiency and demand-response measures will reduce direct and indirect costs to consumers by decreasing environmental impacts and by avoiding or delaying the need for new generation, transmission, and distribution infrastructure." 220 ILCS 5/12-103(a).

The City concludes that imposing unwarranted and unjust costs on customers who use less energy is, at best, inconsistent with the General Assembly's mandate that reducing energy use is a vital policy objective of the State.

The Public Utility Act unequivocally places that burden of proof on the utility. 220 ILCS 5/9-201(c). The City concludes that asserting that the City's analysis is flawed is not the same as proving that ComEd's proposal is just and reasonable.

The City does not propose separate rates for customers depending on what municipality they live in. AG Ex. 6.0 at 17, L. 400-04. The City explains that it recommended that a regional surcharge be imposed on the customers in the portions of ComEd's service area where the growth which ComEd asserts is the primary reason it is seeking more than $360 million rate increase is occurring.

The City asserts that by recognizing cost factors related to density and the difference in costs spent for underground lines versus the costs spent for overhead lines reduces the cost of service for multi-family residential customers by 14% and increases the cost of service for single-family customers by 4%. City Ex. 1.0 Corr. at 18, L. 301-13. The City modifications to ComEd's cost study should be adopted because they more closely attribute costs to cost causers.

ComEd's Cost Study Fails to Account for the Costs Driving the Utility's Requested Rate Increase.

The City recommends that the Commission impose a surcharge on areas within ComEd's service area that the utility asserts are a large cause of its need to request rate relief.

The City explains that Mr. Bodmer's regional surcharge proposal is premised on the utility's assertions that much of its need to seek more than $360 million in rate relief derives from substantial growth in "collar" and "far-collar" counties. The City cites ComEd's President and Chief Operating Officer, J. Barry Mitchell's and ComEd's Senior Vice President, Operations, George A. Williams' testimony that a primary driver for the utility's requested rate increase is the "growth and the relocation of load to the 'collar' and far 'collar' counties. Nevertheless, City residents are being asked to bear a significant portion of the costs needed to expand the ComEd system to meet rapidly growing demand in places far outside of the City.

The City explains that the other component in developing the regional surcharge proposal is Mr. William's testimony that cost increases have outpaced inflation by a great margin over the past few years. ComEd. Ex. 4.0 2nd Corr. at 13-14, L. 251-61.

The City asserts that the cost increases in materials needed to expand the ComEd system cause the ratemaking system to break down. *Id*. at 642-43. The City adds that it would be inequitable for existing ratepayers to pay for explosive growth in "collar" and "far-collar" counties because of the sheer magnitude of the costs ComEd incurs to serve ratepayers moving to far collar counties.

Imposing a regional surcharge on customers who fuel suburban sprawl is good environmental policy because it discourages the construction of homes and businesses that have harmful environmental impacts.

The City notes that ComEd's cost study invariably resolves any ambiguities with respect to the allocation of installation costs, customer information costs, uncollectible costs, density factors, and the allocation of distribution investments using the approach least favorable to low-income, low-use residential ratepayers. City Ex. 2.0 at 3, L. 69-73. In particular, the City argues that ComEd's cost study is flawed because it allocates installation costs, customer information costs and uncollectible expenses based on the number customers in each class. These and a portion of the costs of data management should be allocated on the basis of energy sales rather than the number of customers in the residential class. In addition, the City contends that some data management costs should be allocated to the non-residential classes. City Ex. 1.0 at 59, L. 1062-73.

The City notes that ComEd's practice of allocating these costs based on the

number of customers falls especially hard on low-use and low-income customers because the customer charge is fixed and cannot be avoided even if the customer uses no electricity. ComEd's customer charge for multi-family customers increased from $2.94 per month in 2005 to $7.94 in 2006. ComEd now proposes to increase the customer charge for multi-family customers to almost $10.00. *Id.* at L. 1089–90.

The City notes that ComEd's cost study determines customer costs by summing the costs of customer installation, metering services, billing, customer service and customer information. In terms of revenue requirements, these "customer costs" represent about 20% of the utility's overall cost of service. *Id.* at 62, L. 1126-29. Because ComEd allocates these costs based on the number of customers within a particular class, 80% of these costs are assigned to residential customers. *Id.* at 1129-31. The City argues that ComEd's allocation method is not reasonable. The City recommends that such costs be allocated based on usage.

In the Interim Order in Commission Docket 01-0423, the Commission found that it "agrees that the Company's use of traditional allocations of customer related expenses are of concern and should be reviewed in future filings." In re ComEd, Docket 01-0423, Interim Order at 129 (Apr. 1, 2002).

Customer Installation Costs

As to "customer installation costs," the City states that this category of costs increased more than any other cost item since ComEd's last rate case. *Id.* at 66-67, L. 1208-15. ComEd's witnesses testified that the primary driver of its rate increase is suburban sprawl in fast-growing "collar" and "far-collar" counties. Allocating these costs – by the number of customers in each class – is the most regressive means possible. *Id.* at 67, L. 1217-19. Mr. Bodmer testified that cost allocation principles should dictate that higher use customers, because they require more facilities, should be allocated a larger share of these costs. *Id.* at L. 1219-21. Because ComEd does not have the billing determinants for new customers, the City recommends that these costs be allocated on an energy sales basis across all customer classes. *Id.* at 1221-24. The City further advocates that these costs be reclassified as facility costs rather than customer costs. *Id.* at L. 1224-25.

Uncollectible Costs

The City also criticizes ComEd's method for allocating uncollectible costs. Mr. Bodmer explains that cost allocation principles would dictate that these costs be recovered from those who cause them, but that is impossible because the cost causers did not pay their bills. The City asserts that ComEd currently allocates uncollectible expenses for each sub-class of residential customers to customers within that class. Requiring that low-use, non-space heat, multi-family customers bear the biggest brunt of the allocation of uncollectible costs is the most regressive manner of assignment possible. *Id.* at 68, L. 1235-38. The City adds that ComEd's practice is unfair and increases the likelihood of the utility's implicit prediction that low-use multi-family customers will be the most likely not to pay their bills. A much more fair method is that

residential class uncollectibles should be recovered evenly across all residential classes. *Id*. at 69, L. 1261-66.

Customer Information Expenses

The City explains that ComEd allocates these costs based on the number of customers within each customer class. City Ex. 1.0 Corr. at 70, L. 1269-71. A more fair and reasonable approach would be to allocate these costs based on energy use within each class. Mr. Bodmer also recommends that customer information expenses be reclassified as a facility cost. *Id*. at 1284-85.

Service Drops

The City recommends that because the service costs vary based on the size of a customer's home, service costs should be reclassified from a customer cost to a facility cost. *Id*. at 71, L. 1292-97.

Billing and Data Management Costs

These costs are the largest item that ComEd classifies as a customer costs and each customer pays more than $40 per year. These costs are related, at least in part, to efforts to accommodate deregulation. The City argues that because no residential customers take service from alternative providers, it is unfair that costs related to deregulation efforts be allocated to them. Mr. Bodmer recommends that 20% of billing and data management costs be allocated to non-residential customers. *Id*. at 1329-30.

A&P Allocation

The City recommends that the Commission order ComEd to use the A&P methodology to allocate the cost of the utility's distribution system. The A&P method uses an allocation factor that takes into account both energy usage and peak demand. *Id*. at 75, L. 1372-73. In contrast, coincident peak ("CP") method allocates the cost of the system based on usage in a single hour of the year. *Id*. at 1373-74.

The Commission has repeatedly adopted the A&P method in natural gas rate cases. *Id*. at 78, L. 1427-28. Mr. Bodmer recommends that the Commission adopt the A&P method in this case.

Adopting the MDS method would result in an enormous transfer of costs from non-residential customers to residential customers. Illinois Attorney General ("AG") witness Scott Rubin states that adopting MDS would transfer more than $100 million from commercial and industrial customers to residential customers. AG Ex. 6.0 at 11, L. 250-52.

Dusk to Dawn Lighting

In his pre-filed direct testimony, Mr. Bodmer presents a table showing ComEd's assumptions regarding the costs included in the dusk-to-dawn street lighting class. The City's street lighting account is included in that customer class. ComEd assumes that it incurs all costs listed in the above table to serve all customers in the dusk-to-dawn street lighting class. The City explains that ComEd assumes in calculating street lighting rates that the utility owns the light pole, secondary wire and other components. *Id*. at 81-82, L. 1486-90.

"The City has approximately 193,434 lighting fixtures on 180,611 City-owned poles. The City has approximately 62,230 lighting fixtures on either ComEd-owned or ComEd/AT&T owned poles." City Ex. 2.0 at 21, 561-64, quoting City's Supplemental Response to ComEd Data Request 3.06. Although, ComEd's claim that the City does not own all of the poles used to attach its street lights is accurate, more than 75% of City street lights are attached to City-owned poles. Because ComEd's cost study does not recognize this, ComEd's argument has little merit.

G. CG

Overview

The Commission made clear in ComEd's last rate case that it "endorsed a simple, non-controversial principle: that costs and expenses should be allocated to and recovered from those who caused costs to be incurred." Order on Rehearing, Docket 05-0597 at 73. ComEd's updated class cost of service study is reliable enough for setting rates although it could be improved. Whatever the ECOSS improvements ordered by the Commission, all ECOSS studies in evidence in this case show the Medium, Large, and Very Large Load classes providing returns substantially above cost. Thus, there is no dispute that these classes are subsidizing the rest of the system. There also is no reason for these classes to see their above-cost rates increase by the system average. Instead, the Commission should set rates based on the class cost of service, consistent with its simple, non-controversial principle. In determining whether to deviate somewhat from cost, the Commission should not focus solely on the rate impact between current and proposed rates as some parties suggest, but the total impact of the current rate subsidies and the proposed rate increase of this case. Across-the-board rate increase proposals impose unreasonable rate subsidy burdens on the Medium, Large, and Very Large Load customer classes and should be rejected.

Uncontested Issues

Under all ECOSS studies performed in this case, the Medium Load, Large Load, and Very Large Load classes are allocated substantially more costs than ComEd incurs on their behalf, and hence these classes subsidize other classes. A system average rate increase would increase this subsidy. A rate rider based on a percentage of current revenue would further increase this subsidy.

Embedded Cost of Service Study Issues

CG witness Baudino closely examined ComEd's class cost of service study ECOSS and found it generally reliable. Finding the ECOSS to be generally reliable does not mean, however, that the study could not be improved. Two needed improvements are differentiation of primary and secondary cost responsibility and the use of a minimum size distribution system study to better classify and allocate certain distribution system costs. If the Commission agrees that some minimum distribution costs should be captured as customer costs, the Commission should adopt the results in Mr. Stowe's Table 8, IIEC Ex. 3.0 at 49. If not, the Commission should adopt the results in Mr. Stowe's Table 7, IIEC Ex. 3.0 at 25. However, even if the Commission adopts neither of these improvements in this case, ComEd's ECOSS is a suitable foundation for setting rates.

Primary/Secondary Split

Witnesses for IIEC, DOE, Kroger, Staff, and the Commercial Group all concur that primary and secondary voltage level costs should be better differentiated. Witness Stowe performed an analysis of a cost study that better differentiated primary and secondary voltage costs. See IIEC Ex. 3.0 (Stowe direct) at 25 (Table 7). That study showed that the Very Large Load class provides nearly a 300% return above cost, that the Large Load class returns about 150% of cost, and that the Small and Medium Load classes are above cost. *Id.*, see also CG Ex. 2.0 (Baudino rebuttal), at 6 (Table 1). Rates should be set based on this improvement to ComEd's cost study.

Minimum Distribution System

Although the Commission has not adopted a minimum distribution system ("MDS") analysis in recent years, IIEC provides the Commission with important new data and rationale for the MDS, including the fact that utilities incur a minimum amount of cost to employ facilities that comply with technical and safety standards. Such minimum cost does not fluctuate with demand or energy usage differences and therefore should be captured as a customer cost. The Commission should direct ComEd to include such MDS costs as customer costs in any future class cost study. As IIEC witness Stowe demonstrates in his MDS study, proper allocation of MDS costs to customer count instead of demand (and proper differentiation of primary and secondary costs) show that the Small to Very Large Load classes provide returns between 179 percent and 483 percent of cost. IIEC Ex 3.0 at 49 (Table 8). The CG says that rates should be adjusted accordingly so that all classes pay the true cost of their electric service.

Average and Peak Methodology

The CG argues that there is no reason to adopt this methodology as it is appropriate for consideration only in allocating generation costs, and this case concerns distribution costs. See Kroger Ex. 2.0 Higgins rebuttal at 8-10.

Customer-specific cost of service recommendations

The CG agrees with ComEd that the numerous customer-specific cost studies that have been requested could be very costly to perform. The Commercial Group believes that ComEd should identify and directly assign as many costs as can feasibly be studied and determined. That being said, determining what specific costs each customer incurs is in Mr. Baudino's words is "extremely difficult, if not impossible." Tr. 1645, lines 20-22. Based on the record in this case, ComEd's failure to perform one or more of the requested customer-specific cost studies does not render ComEd's COSS invalid.

Rate Impact Analysis

When considering any potential "rate shock" of the proposed increases from existing rates, the Commission should not shut its eyes to the cumulative rate impact from long-standing subsidies. Under ComEd's CCOS study, the Small, Medium, Large, and Very Large Load classes pay more than their fair share of costs, *i.e.*, these classes provide a relative return of 29%, 31%, 30%, and 37% above cost, respectively. CG Ex.

2.0 at 6 (Table 1). Further, all cost studies in evidence show that the Medium, Large, and Very Large Load Classes substantially overpay for electric distribution service. Thus, schools, homeless shelters, commercial customers, and small industrial customers in ComEd's territory have already borne a heavy subsidy burden of hundreds of millions of dollars since 2001. BOMA similarly points out that customers with electric loads of between 400 KW and 3000 KW (*i.e.*, customers in the Large and Very Large Load classes) have suffered the largest percentage distribution rate increases of any ComEd customer groups from 1999 to 2007. To make matters worse, the Small, Medium, Large, and Very Large Load customer classes could see their subsidy burden increase to $63.6 million each year under the "across-the-board" rate increase proposals. It is not fair for those classes to bear the impact of even greater subsidies for the sole purpose of presenting rates as increasing by the same percentage.

Interclass Allocation Issues

The Commission should stick with its principle – setting class rates at class cost is the fairest method.

Across-the-board increase

According to ComEd's witness Crumrine, ComEd's commercial customers may already have provided about one-third of a billion dollars in subsidies the past seven years simply to customers in the three largest load classes. These commercial customers deserve to pay only the cost to serve them; they instead are being asked to pay even higher subsidies to other customers under Staff's across-the-board rate proposal.

Under this across-the-board rate increase approach, the current interclass subsidies would be exacerbated, and there would be no progress toward cost-based rates. Indeed, as rates increase, the subsidies actually become more pronounced.

Witness Crumrine pointed out (Ex. 30.0 at 49, line 1110) that those paying the subsidy include small and medium businesses, schools, churches, and homeless shelters. It is not fair or good public policy for retail businesses, schools, churches, and homeless shelters to continue to subsidize other customers.

The Commercial Group agrees with ComEd (Init. Br. at 100) that the across-the-board increase should be rejected because it is not cost-based and because "fairness is more likely to be achieved when an objective standard, such as an ECOSS, is used to set rates." In arguing for an across-the-board increase, Staff proposes a subjective standard for setting rates based on which customers "can more easily absorb increases in delivery services costs." Staff Init. Br. at 101. It is unclear how a class's relative ability to absorb rate increases could be measured in a fair, meaningful and transparent manner. However, ability to absorb rate increases (or willingness and ability to organize and advocate) is not a fair, objective way to set rates; cost is the fairest basis for setting rates.

A number of across-the-board increase advocates cite positively one or both of IIEC witness Stowe's cost studies, yet advocate an across-the-board solution that would penalize the customers that are above cost in every cost study in the record, including

those of Mr. Stowe. In fact, both of Mr. Stowe's studies show that rates of the Medium, Large, and Very Large Load customer classes are above cost or even further above cost than under ComEd's study. If the fundamental problem with ComEd's cost study is corrected by Mr. Stowe's improvements, as these parties suggest, how could the fair remedy be for these above-cost customer classes to pay even greater subsidies under the across-the-board proposal?

Other Rate Moderation/Mitigation Proposals

Rates should be set on cost, but to the extent the Commission wants to make an exception for public policy reasons, the Commission should spread such subsidy responsibility as broadly as possible, particularly to those customers who are paying below cost rates. What is patently unfair about the various rate design subsidy/"mitigation" proposals is that they rely on commercial and public interest customers to pay the subsidy, even though those customers have been doing so for years. Why should a church, homeless shelter, or school be less favored than a train or plane or federal government facility? Why should a small industrial customer or small commercial customer be less favored than a large industrial customer? As Witness Vite points out, retail businesses already subsidize public transport in the Chicago area through taxes. Tr. 1673-74. Fifty percent of revenues to local governments come from sales tax revenue generated by retailers. CG Ex. 1.0 (Vite rebuttal) at 3. Payments by retailers of Personal Property Tax Replacement Income Tax adds more to local government coffers, and retail establishments pay 25 percent of all property taxes levied in Illinois. *Id.* Nevertheless, intervenor groups ask for more. Perhaps these entities deserve a rate subsidy – but not at the expense of retail establishments, churches, homeless centers, and schools.

CG argues that only so much revenue can be squeezed from the commercial sector. As retailers are faced with rapidly escalating transportation costs, continuing and even escalating electric service subsidies will cause meat, poultry, milk, produce, pharmacy, and other consumer good prices to rise, which would only burden Illinois families. *Id.* at 6. If the Commission wants to accomplish societal benefits through electric rate subsidies, the burden of subsidies should be spread as broadly as possible, particularly to customer classes that are below cost.

Supply vs. Delivery Services Allocation Issues

REACT raises important issues concerning the proper allocation and recovery of supply-related costs. REACT witness Merola points out that other utilities have allocated supply/administrative costs two to three times as high as ComEd. REACT Ex. 7.0 (Merola rebuttal) at 25, line 29 (Table). While ComEd allocates all or nearly all customer information costs to the delivery function, ComEd witness Clair admits all the types of customer care costs ComEd currently has would be incurred even if ComEd provide no delivery service. Tr. 282, lines 17-19. Therefore, a significant portion of such costs should be allocated to the supply function. Given that ComEd has the burden of proof to show it has properly allocated costs, in the absence of any allocation of such costs to the supply function, the Commission should adopt witness Merola's recommendation to remove $64.86 million of Customer Care Costs from distribution rates.

C. AG

Interclass Allocation Issues

Across-the-board increase

The AG points out that several nonresidential Intervenors have argued that ComEd's cost of service study is seriously flawed. CTA witness Anosike proposes to limit the Railroad class distribution charge to the system average increase or the residential increase, whichever is lower. CTA Ex. 1.0, p. 6. These Intervenors reject the study and propose to raise nonresidential rates across-the-board by the overall jurisdictional percentage increase, 21.2%. The AG only rejects ComEd's cost of service study as it applies to the nonresidential class, not to the residential class, and they propose raising rates for the residential class by 24.7%, which is the residential increase in ComEd's cost of service study.

The AG argues that if the Commission were to find that ComEd's cost of service study is flawed as applied to the nonresidential class, then the Commission should find that it is flawed as applied to all customers (*i.e.* residential). *Id*. at 79. AG witness Rubin argues that if the cost of service study is rejected because it is flawed, then "all customer classes should receive the same percentage increase" because there is "no basis for assuming that any customer class should receive more or less than the system-average rate increase." AG Ex. 6.0 p. 7-8 (emphasis in original). The AG asserts that non-residential Intervenors want it both ways: they want the residential class to pay higher than average increases for the residential class based on the cost of service study while arguing that the cost of service study is seriously flawed as it applies to the nonresidential class and should be rejected. AG IB, p. 79.

The AG maintains that to apply a different standard for the residential as opposed to the nonresidential class violates fundamental fairness and would impose discriminatory rates on the residential class without any factual basis. *Id*.

Shifting of Burden from Non-residential to Residential Class

The AG supports ComEd's residential rate design proposal, as it is the more reasonable proposal and avoids adverse impacts on customers by balancing cost of service and the impact of any rate changes. AG Ex 6.0, 121-122. This is done solely through intra-class rate design within the residential class. AG Ex. 6.0, 133-134. This proposal makes no changes in the four residential customer classes that the Commission ordered ComEd to retain in Docket No. 05-0597: single-family space-heating; single-family non-heating; multi-family space-heating, and multi-family non-heating.

However, the AG takes issue with several proposals of Intervenors who want to shift nonresidential costs to the residential class. AG IB, p. 79. IIEC's Embedded Cost of Service Study ("ECOSS") proposal shifts 14% of the total revenue requirement from the nonresidential to residential classes compared with ComEd's ECOSS. See IIEC Ex. 3.3 and ComEd Ex. 33.1. This amounts to the transfer of over $100 million in costs from commercial to residential customers.

AG witness Rubin urges the Commission to reject any proposal to alter the residential rate design if it contains inter-class, as opposed to intra-class, cost allocation. *Id*. Mr. Rubin agrees that ComEd's residential rate design is reasonable in that it allocates only residential costs to the residential classes and he states that inter-class rate design is an appropriate use of rate design principles. AG Ex. 6.0, 120-44. ComEd did not propose to move any of the residential class' costs onto other customer classes; it only modified rates within the residential class to try to mitigate the rate impact on space-heating customers. AG Ex. 6.0, p. 6. Such a rate design proposal correctly provides that a class bears its own responsibility for costs it has caused instead of shifting those costs to another party.

The AG urges the Commission to reject any arbitrary and discriminatory proposal to shift costs from nonresidential customers to residential customers. *Id*. ComEd's rate design properly allocates the residential class' costs between the members of the residential class and requires the customers responsible for the costs to pay for those costs. *Id*. The AG maintains that the nonresidential Intervenors in this case have not offered any evidence as to why the residential class should bear nonresidential costs that they have not caused. *Id*. ComEd's cost of service study adequately allocates costs to the customers who cause those costs and does not allocate them in an arbitrary or discriminatory manner between classes. *Id*. For this reason, the AG urges the Commission to reject the proposal of IIEC and other Intervenors to allocate nonresidential costs to residential users. *Id*.

D. RESA

RESA supports the argument made by REACT that the Commission should adjust ComEd's rates to reflect the supply-related costs it currently charges delivery services customers. RESA agrees with REACT that it is unfair to burden those customers who choose a RES for supply service with ComEd's costs associated with providing supply. RESA notes that ComEd's primary argument against the REACT adjustment is that REACT's 40% allocation is arbitrary and that there is no specific evidence supporting an allocation. RESA notes that ComEd has the burden to prove that its position of zero allocation is correct and has not done so.

E. BOMA

Overview

BOMA advocates the utility of marginal cost principles, at least in setting tariff elements, such as ComEd's energy efficiency or Rider SMP surcharges. BOMA Ex. 5.0: 4-7, 24-95. The current practice of establishing tariffs based only upon average costs may distort price signals and result in system inefficiencies. *Id*. BOMA proposes that ComEd should be required to file both marginal and average cost studies in any request for increases in rates. *Id*.

Rate Impact Analysis

The rate impact analysis submitted by ComEd simply compares current rates to proposed rates and fails to take into account the longer term trend in electric rate increases. In contrast, BOMA provides analyses that tracks the ComEd rate increases,

on a bundled and unbundled basis, since 1997. BOMA Exs. 1.0, 2.0, 2.2. BOMA asserts that tracking historical rate increases, as t has done in its analyses, is critical for moderating rate increases and in protecting against distorted rates and inappropriate increases for certain classes.

Interclass Allocation Issues

Across-the-Board Increase

BOMA urges the Commission to recognize marginal cost principles; however, it acknowledges that average cost principles does provide some justification for setting rates. BOMA suggests that providing, once again, for an across the board rate increase is legally insubstantial and ignores sound rate-making principles. If the Commission employs rate mitigation relief for customers, the Commission should look at such mitigation from a historical context as shown in BOMA Ex. 2.2, before deviating from cost-based rates.

BOMA further recommends that the Commission adopt IIEC Witness Stowe's allocated cost of service study which makes various adjustments to the Company's proposed study, including delineating between primary and secondary voltage (s*ee*, IIEC Ex. 7.2). Given that many parties challenge the veracity of ComEd's allocated study, BOMA states that it would appear that IIEC's cost of service study is the most credible and should be utilized by the Commission, *See* IIEC Initial Brief at 81.

F. CTA

Primary/secondary Cost Allocation

The CTA believes the Commission should base rates in this Docket on a revised ECOSS that includes a primary/secondary cost allocation and a minimum distribution system. ComEd's cost of service study has two flaws related to the Railroad Class. The first is that the study does not distinguish or track the costs imposed on the system by the primary and secondary distribution systems. Because of this, the ComEd ECOSS erroneously concludes that other customers are "subsidizing" the CTA.

Using ComEd's incorrect and flawed ECOSS, the Railroad Class Return on Rate Base is (2.4%). *See*, Stowe Direct, IIEC Ex. 3.0 Corr. at 10/Table 1, line 16. By allocating costs between primary and secondary, the problem of unfairly allocating secondary costs to primary customers is eliminated. *See*, IIEC Ex. 3.0 Corr. at 407-409. When this is done, the Railroad Class' Return on Rate Base changes from a negative to a positive. The IIEC analysis of the primary/secondary split shows that, contrary to ComEd's assertion, the Railroad Class is not being subsidized by other customers. For this reason alone, ComEd's request to increase the Railroad Class' rate by 124% must be rejected.

Minimum Distribution System

A second major failing of ComEd's ECOSS is that ComEd ignored the fact that there are delivery service costs directly attributable to electric industry mandated safety and reliability requirements for distribution facilities that do not vary with customer demand. Those costs should not be allocated on the same basis as demand-related

distribution system costs. The CTA favors the minimum distribution system ("MDS"). Because the cost of the MDS is unrelated to demand but directly related to the number of customers, it is properly classified as a customer cost and distributed to the classes proportionate to the number of customers in each class.

As with the correction to the ECOSS for the primary/secondary voltages, using MDS further demonstrates the fundamental error in ComEd's argument that the Railroad Class is being subsidized by other customers. It is more appropriate to use the IIEC corrected ECOSS as the ceiling for the Railroad Class rates since it does not include consideration of the public policy issues recognized by the Commission in Docket No. 05-0597.

Customer Class-Specific Cost Identification Study Recommendations.

The CTA believes that the Commission should require ComEd perform a specific cost identification study to identify distribution investment and expenses specifically related to the Railroad Class.

The record shows that information for a specific COSS for the Railroad Class is readily available. ComEd produced specific one-line diagrams and identified specific distribution circuits and substations that are used to serve the Railroad Class. During the hearing, ComEd confirmed that its one-line diagrams for CTA traction power substations shows the circuits by circuit number and goes back to the ComEd substation. Tr. at 465:8-14. These can and should be used for the cost identification study. The CTA requests that the Commission require that ComEd involve the two customers in the class (the CTA and Metra) in formulating and carrying out the study. The results of the study should be fully utilized as part of the customer class cost of service study submitted as part of ComEd's next general rate case.

Across-the-board increase

The CTA believes that because ComEd's ECOSS is fundamentally flawed, it cannot be used to allocate a rate increase to ComEd's customers. The Commission should raise rates across the board for all classes.

New Cost of Service Study

In its brief on exceptions, the CTA suggests that the Commission should order ComEd to file its next (and substantially different) ECOSS sixty days prior to filing for another rate increase. In response, ComEd argues that this suggestion is impractical, not provided for in the Public Utilities Act and unnecessary, because the eleven month statutory deadline provides adequate opportunity to analyze its filings.

G. Metra

In the last delivery services rate case filed by ComEd, the Commission expressed doubts about the reliability of the results produced by ComEd's ECOSS for its largest customers. Docket 05-0597, July 26, 2006 Final Order at 196. The rates set for these customers in the last rate case, which includes members of the Railroad Class, were not based on ComEd's ECOSS. *See*, *id*. at 189-90 and 196.

It is axiomatic that it costs less to serve large customers at higher voltages than

customers who take service at lower voltages. ComEd's Retail Rate Manager, Lawrence Alongi, acknowledged that fact in his testimony. The only two members of the Railroad Class, Metra and the CTA, are among ComEd's largest customers and are served exclusively at 12.5 kV, which is a higher, primary voltage.

The rates proposed by ComEd in this case for the Railroad Class are based on ComEd's ECOSS analysis. Tr. at 1136-37. These rates, on a kilowatt per hour basis, would set the Railroad Class rates higher than any other non-residential class other than the Watt Hour and Small Load classes. ComEd Ex. 11.0 at 10, Table 2. Metra believes that there are fundamental flaws in ComEd's ECOSS that cause it to generate inflated rates for the Railroad Class.

If authorized by the Commission, ComEd's ECOSS based rates will have a significant impact on Metra and the CTA, the two Railroad Class members. The rates that ComEd initially proposed for the Railroad Class would have involved a 121.1% increase in the Railroad Class' overall delivery services charges. ComEd Ex. 11.0 at 10, Table 2. Later, ComEd introduced its so-called "mitigation proposal" under which the increase in the distribution facility charge to the Railroad Class and two other classes would be reduced by 50%. *Id*. at 9:142-45. Metra questions the accuracy of ComEd's calculation of the cost to serve the Railroad Class. Metra Ex. 4.0 at 7:10 to 8:7.

Metra agrees with the other Intervenors that ComEd's ECOSS fails to distinguish between costs associated with primary and secondary voltage facilities. As a result, it allocates the cost of the primary and secondary distribution among all of ComEd customers who take electricity at voltages less than 69KV. *Id*. ComEd does not utilize any part of the secondary voltage system to serve the Railroad Class. As a result, it generates significantly inflated rates that are not based on the Railroad Class' true cost of service.

Metra also favors the MDS approach to allocate those costs that are not demand related. Metra believes that the lack of a valid COSS requires that the rates for all classes should be based on an average, across-the-board increase. If the Commission is not persuaded that ComEd's ECOSS is fundamentally flawed, Metra believes that the public interest considerations required by the Commission in the last rate case should cause the Railroad Class rates to be set based on either the average system rate increase or the average residential class rate increase. Metra also believes that future Railroad Class rates either should be established based on a specific cost identification study or on a study that separates the cost of primary and secondary voltage usage and utilizes the minimum distribution system analysis addressed in Mr. Stowe's testimony.

Metra requests that the Commission order ComEd to meet with Metra and the CTA to agree on the scope and project timeline for the special cost identification study to be included in ComEd's next rate case ECOSS so that future controversies might be eliminated or significantly reduced.

Metra urges the Commission to adopt an average, across-the-board increase. ComEd objects to this proposal. All of ComEd's arguments are based on the incorrect assumption that ComEd's ECOSS is not flawed, and that it is perfectly logical that the

cost to serve the Railroad Class is greater than all but two very small non-residential delivery service classes. Under the circumstances, Metra submits that an average across-the-board increase is the most fair and reasonable result.

H. Nucor

Interclass Allocation Issues

Across-the-board increase

Nucor objects to the failure to differentiate its costs of serving high voltage ("HV") customers at 69 kV or higher (*i.e.*, high voltage HV customers) versus HV customers served at voltages below 69 kV (*i.e.*, standard voltage HV customers). Consequently, all high voltage and standard voltage HV customers are jointly assigned responsibility for distribution costs allocated to the class, even though ComEd does not incur selected investment costs and related expenses to serve the high voltage HV customers.

This error, in turn, results in proposed ComEd Distribution Facility Charges ("DFCs") that are too high for high voltage HV customers and too low for standard voltage HV customers.

Nucor recommends a two-step approach that not only addresses the immediate problem of ComEd's proposed huge, non-cost-based increases for high voltage HV customers, but also identifies a longer term solution. As an interim step to mitigate the huge, non-cost-based increase for high voltage (69 kV and higher) customers, the Commission in this case should increase DFCs for the HV class no more than the system average increase (if any). If the Commission reduces ComEd's rates in this case, DFCs for the HV class should be reduced by the system average decrease. As a long-term step to addressing this intraclass problem, the Commission should require ComEd in its next general rate case to identify separately its cost of serving high voltage HV and standard voltage HV customers, and to develop DFCs to reflect these costs.

I. Kroger

Embedded Cost of Service Study Issues/Average and Peak Method

Kroger opposes the adoption of the Average and Peak method for allocating electric distribution costs. The Average and Peak method is clearly inappropriate for application to distribution costs. Distribution costs are customer-related and demand-related; they are not energy-related. The NARUC Cost Allocation Manual states:

> "…[A]ll costs of service can be identified as energy-related, demand-related, or customer-related. Because there is no energy component of distribution-related costs, we need to consider only the demand and customer components."

The Average and Peak method was proposed in this case in order to artificially shift cost responsibility away from residential customers. ComEd's ECOSS approach already shifts costs away from residential customers relative to other well-recognized approaches to allocating distribution costs, such as the MDS approach, which generally classifies more costs as customer-related.

Interclass Allocation Issues

Kroger supports Commission Staff's proposal that the Medium, Large, Very Large, and High Voltage (other) classes be combined into a single DFC, with a slight modification. Commission Staff is correct that once customer-related costs are accounted for, the most important cost distinction for delivery service among non-residential customers is the voltage at which customers take service. This is a far more important distinction than a customer's size. For customers of identical voltage and load usage patterns, size is largely irrelevant insofar as per-kW delivery costs are concerned.

The primary reason for a disparity in ECOSS results is load diversity within a customer class. Load diversity refers to the ability of a delivery system to accommodate the peak demand requirements of individual customers using a delivery system that is smaller than the sum of the individual peak demands, because all individual customer peak demands do not occur at the same time. For customer classes taking service at the same voltage level, a class with greater load diversity will have a lower per-kW cost of service, all other things being equal.

Kroger supports the adoption of Staff's proposal subject to an adjustment that recognizes the cost of service difference between customers taking service at different voltage levels. All other things being equal, customers taking service at lower voltage levels require more delivery infrastructure costs per-kW than customers taking service at higher voltages. Consequently, Staff's proposal may not be appropriate for the High Voltage (Other) class. Instead, ComEd's proposal to mitigate the rate increase for this class by moving it only 50% toward cost-of-service is a preferred (short-term) option. Additionally for same reasons discussed above, Staff's proposal to consolidate the DFC rates is applicable to the Small Load class, which was excluded from Mr. Luth's proposal. The Small Load class should be included in a DFC rate consolidation if not in this proceeding, then in the next one.

ComEd has revised its original proposal to set rates equal to its ECOSS results, and instead is proposing that four rate classes: Extra Large, High Voltage over 10 MW, High Voltage (Other), and Railroad be moved 50% of the way toward cost of service. The cost of this mitigation would be recovered by increasing rates for all other non-residential customers.

The percentage rate increase faced by the classes targeted for mitigation is very substantial; however, the rates these classes would pay at full cost-of-service is still lower, for the most part, than the rates of the non-residential classes that would be burdened with the subsidy. This is apparent from reviewing Table R3 on page 8 of the Rebuttal Testimony of ComEd witnesses Lawrence S. Alongi and Chantal K. Jones. It is not reasonable for those customers paying higher rates to shield other customers with substantially lower rates from the full burden of paying rates based on cost. For this reason, the Company's proposal should be rejected as inequitable.

J. Commission Analysis and Conclusion

Cost-causation principles seek to ensure that all customers are paying their fair share for distribution service. ComEd asks the Commission to approve its modified,

proposed interclass allocation. In its modified allocation plan, ComEd proposes that distribution facilities charges for the Extra Large Load Delivery Class, High Voltage Delivery Class, and Railroad Delivery Class be increased half way to what it considers cost based rates. ComEd Ex. 32.0 Corr. at 9. Under ComEd's revised proposal, these customer classes would move to "cost-based" rates in two steps, after which the "alleged" subsidies borne by the other nonresidential customer classes on their behalf would be eliminated.

Staff and Intervenors take issue with ComEd's proposed rates, which for some customer classes are several times current rates. The rates in effect at the time of this hearing were deemed just and reasonable by the Commission barely two years ago. Intervenors argue ComEd's rates are dramatically higher than those approved for large customers of other Illinois utilities. Intervenors claim that numerous flaws in ComEd's ECOSS make its use to set rates in this case inappropriate.

Primary/Secondary Costs

ComEd's network can be divided into primary and secondary service on the basis of voltage. Some customers take electric service at high voltage only. These are primary customers. They comprise .2% of customers, yet they represent 20% of the system's peak demand. Of the $2 billion projected as ComEd's cost of service, more than $920 million is due to distribution lines. Installing, operating and maintaining the secondary system takes a large but un-quantified amount of money. ComEd fails to separately allocate these to secondary customers. Intervenors representing primary customers allege that about $88 million of these costs are allocated in error to primary customers, significantly raising their cost of service. IIEC Ex. 3.0 Corr. at 12-13; CG Ex. 2.0 at 4; DOE Ex. 1.0 at 16. This failure of the ECOSS to separate costs results in customers who only take service at primary voltages paying substantial amounts of secondary distribution costs attributable to other customer classes.

ComEd contends that a primary/secondary cost differentiation is neither practical nor necessary. ComEd says it is not required to record its gross plant or accumulated depreciation on its books in a manner that would facilitate changing the ECOSS to recognize the primary/secondary distinction. ComEd Ex. 33.0 Corr. at 3. On cross examination Mr. Heintz admitted he did not know what such an analysis would cost and that no one at ComEd had attempted to determine what the cost would be. Intervenors offered expert testimony that it is neither difficult nor expensive to make this analysis.

ComEd admits that the assignment of primary and secondary distribution costs would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage, and Railroad delivery classes. Although admitting on cross examination that it did not know how expensive this analysis would be, ComEd, nevertheless argues that the cost of the primary secondary analysis exceeds the benefits because the benefits would flow to a small number of customers. This overlooks our explicit policy objective of assigning costs where they belong. Only customers using the primary system would see lower rates but the assignment of costs and the rates charged to all classes would be effected. Moreover, the secondary costs assigned to these primary customers substantially change the cost of serving this small number of customers.

Under ComEd's original proposed rates, the primary service customer classes would experience larger rate increases than other classes. Because of the magnitude of the increase, ComEd proposed a revised "mitigation plan" that would put the full rate increase into effect in two equal installments. The first half of the rate increase would go into effect at the completion of this proceeding and the second half after ComEd's next rate increase. ComEd argues that its modified proposal provides for a phased-in transition to fully cost-based delivery service rates for all delivery classes. ComEd asserts that the first phase of this proposal results in rates that do not exceed those that would arise from the separation of primary and secondary costs for those in the effected classes.

ComEd argues that even if the Commission were inclined to direct ComEd to incorporate this approach in the ECOSS in ComEd's next rate case, there is no reason why the Commission should be reluctant to approve rates that increase recoveries from under-recovering classes now in order to move all customer classes closer to cost.

In response, the DOE points out that imposing half of the proposed rates on these classes still results in a 71% increase for the extra large load class, 47% for the above 10MW class, and 62% for the railroad class and the less than 10MW class. Importantly, ComEd's position assumes that these customer classes are paying far less than their cost of service under existing rates. The Intervenors belonging to the effected classes contend that ComEd has failed to demonstrate that their current rates fail to cover the cost of service.

ComEd countered that IIEC's calculation is inaccurate but failed to provide its own calculation of the proper allocation of the primary/secondary cost split.

Having considered the evidence and arguments of the parties, the Commission finds that the ECOSS is deficient in not separating and properly allocating primary and secondary service costs.

Customer Costs Not Allocated To Supply Customers

In addition to the primary/secondary cost discrepancy, Intervenors REACT, CG and RESA contend that the ECOSS is in error because it fails to assign any customer service costs specifically to "bundled supply" customers for ratemaking purposes. Customer service costs are allocated to all distribution customer classes. ComEd witness Crumrine acknowledged that a very small percentage of these costs are attributed to "bundled supply" customers. ComEd asserts that because these costs would not be avoided if these customers found a new supplier, it is appropriate to assign them across the board to all classes

REACT's witness asserts that perhaps 40% or $64.8 million of customer service costs should be assigned to supply customers. ComEd argued that all customer care costs should be assignable to all distribution customers and that it is inappropriate to make a specific allocation to residential and small business customers who take supply from ComEd.

The Commission is not convinced that either position is correct. The Commission believes that some percentage of customer care costs may well be

attributable specifically to bundled supply customers. This allocation could substantially reduce costs assigned to distribution customers while increasing bundled supply rates. The Commission believes that it is reasonable to investigate the allocation of customer care costs.

Street Lighting

The City of Chicago contends that the assumption in the ECOSS that all City street lights are owned and maintained by ComEd is untrue. City Ex. 1.0 Corr. at 81. The City argues that this false assumption may significantly distort the calculation of the cost of service for the dusk to dawn rate class at least in the City of Chicago.

In response, ComEd incorrectly claims that the City argues that it owns all of the City street lights. ComEd points out that it owns and maintains all of the alley and street lights mounted on its poles. The City does not claim to own all of the lights, but claims and has provided evidence that it owns the street lights which constitute more than 75% of the street and alley lighting in the City. City Ex. 2.0 at 21.

Thus, contrary to the assumptions in the ECOSS, Chicago owns and maintains most of the light poles, secondary wire and other components of street lights throughout the City. The ECOSS fails to take into account this division in ownership and maintenance responsibilities. Therefore, the rate for street lighting in the City and probably other municipalities that own all or part of their own lighting is likely higher by a significant but un-quantified amount than it should be.

Other Cost of Service Issues

i. Minimum Distribution System

ComEd's proposed ECOSS does not reflect the minimum distribution system ("MDS") concept. ComEd Ex. 33.0 Corr. at 4. IIEC, Metra, the CG and the CTA assert that ComEd's ECOSS is flawed because it fails to recognize distribution system components that do not vary with demand. IIEC Ex. 3.0 Corr. at 14, 27; CG Ex. 2.0 at 4-5. The proponents of MDS argue that some portion of distribution-related costs should be identified as caused by the existence of customers and the requirement that ComEd meet minimum National Electric Safety Code Standards in providing service. The argument is that this portion of distribution costs should be allocated to customer classes on the basis of number of customers in the various classes rather than demand. *Id.* at *32.* This allocation method would attribute more costs to residential classes.

As it has in the past, *see, e.g.* Dockets 05-0597, 99-0121 and 00-0802, the Commission rejects the minimum distribution or zero-intercept approach for purposes of allocating distribution costs between the customer and demand functions in this case. In our view, the coincident peak method is consistent with the fact that distribution systems are designed primarily to serve electric demand.

The Commission believes that attempts to separate the costs of connecting customers to the electric distribution system from the costs of serving their demand remain problematic. We reject the use of the MDS in this proceeding, and find that ComEd's ECOSS was correct in not reflecting the MDS concept. Accordingly, the Commission rejects the use of IIEC's COSS because it relies on the use of MDS.

ii. Average and Peak Methodology

The City of Chicago requests that the Commission require ComEd to revise the ECOSS so that it incorporates the Average and Peak ("A&P") method for allocating distribution-related costs. The City apparently embraces the A&P allocation method because it attributes more costs to non-residential customers than to residential customers. The A&P approach produces an effect directly opposite to that produced by MDS described above. There is no evidentiary basis in the record reflecting an ECOSS based on this methodology.

The Commission has previously adopted the A&P methodology for distribution costs in natural gas rate cases. As we stated in Docket 05-0597, because of similarities between gas and electric distribution businesses, the Commission remains open to adopting an A&P allocation based upon a more thoroughly developed record in future electric distribution rate cases. However it is incumbent upon the proponents of this methodology to introduce an A&P ECOSS into the record so that its merits can be compared and contrasted with other cost assignment plans.

On the basis of this record, we reject the use of the Average and Peak method in this proceeding.

iii. Customer-Specific Cost of Service Study Recommendations

REACT proposes that the Commission order ComEd to perform individualized cost of service studies to identify the distribution costs for particular customers or customer classes. An individualized study for each customer's point of service would require ComEd to determine the cost for each component part of its distribution system serving any given customer, starting at the customer's meter and extending all the way through ComEd's system to the transmission substation. ComEd Ex. 32.0 Corr. at 17. Metra and the CTA request a "cost identification study" which they contend is different from and simpler than a cost of service study. Metra and the CTA insist that ComEd already has most of the information needed to provide cost identification studies.

ComEd asserts that these studies would be extremely complex. ComEd says it would have to determine the costs of miles of individual components used to serve just one point of service. ComEd says it would not easily be able to directly assign to these customers the portion of the investment or O&M costs incurred to serve them from the entire distribution system. *Id.* at 17.

Some Intervenors argue that the ECOSS would be improved if ComEd conducted "audits" of the facilities used to serve selected classes and used the results to directly assign those facilities to such classes. Direct assignment of costs is far more complicated than allocation of costs by customer class requiring numerous determinations, such as the extent each facility is used by a customer and the development of the corresponding cost. Those determinations would then have to be repeated for each customer class and updated for each rate filing. ComEd also suggests that individual cost of service studies would lead to controversy between individual customers and ComEd over specific cost assignments.

Given the time constraints inherent in rate making, the Commission finds that requiring ComEd to extend the level of cost study scrutiny to that of evaluation of each individual large customer would be unwise. A granular analysis of costs on a customer by customer basis even for a small class of customers would likely significantly increase the number of issues and the number of litigants in these proceedings. The Commission rejects the individual cost study proposal.

iv. Regional Delivery Service Rates

The City notes that the ECOSS allocates "customer costs" based on the number of customers in a class rather than on usage. Some 80% of these customer costs are allocated to the residential customer class on a *pro rata* basis. ComEd witnesses have testified that growth in customer installation costs in outlying areas is the primary driver of this rate increase. The City argues that residential customers in areas experiencing low growth rates and those customers in densely populated areas with predominantly overhead lines (City residents and residents of older suburbs) are subsidizing customer installation costs in less densely populated, high growth areas serviced by more expensive underground service. The City argues that new residential installations tend to be for larger homes using more energy and that most of the new installations are taking place in the collar counties.

The City recommends that ComEd utilize regionally differentiated delivery service rates for customers located in Cook County (*i.e.*, the City), collar counties and far collar counties. City Ex. 1.0 at 17. In a similar vein, the City proposes that rates should be set on a county-by-county basis so that costs ComEd incurs in a specific county are recovered only from customers located in that county. *Id.* at 42. ComEd argues that neither proposal reflects how it actually provides service to residential customers or how ComEd actually tracks its costs.

ComEd argues that the first proposal reflects a misapprehension that investment costs incurred by ComEd in places outside of the City are inappropriately being recovered from customers inside the City. ComEd Ex. 32.0 Corr. at 23. ComEd argues that based upon historical data, approximately 26% of ComEd's customers' energy (kWh) usage is attributable to customers inside the City. *Id.* The same is true for ComEd's investments costs – approximately 26% is expended for facilities inside the City. *Id.* A comparison of investment in plant to energy use inside and outside the City over the past four years shows that investment inside and outside the City tracks closely to historical usage inside and outside the City. *Id.* In particular, 23% of total investment dollars between 2004 and 2007 were specified as having been expended inside the City. *Id.* In addition, some of the unspecified investment costs were likely expended inside the City. *Id.*

ComEd also argues that the City's second proposal relies upon the presumption that the costs of serving suburban or rural counties in ComEd's service territory are higher than the costs of serving urban counties. ComEd Ex. 32.0 Corr. at 28-29. ComEd argues that this assertion is not necessarily true.

ComEd does not maintain cost data or investment data on a county-by-county basis. Tr. at 1490-1491. ComEd argues that its system is not configured on a county

by county basis. Finally, most, if not all, counties in ComEd's service territory have areas experiencing either expansion or gentrification that requires new distribution facilities, as well as areas that require maintenance and replacement of older facilities. ComEd Ex. 32.0 Corr. at 29.

The AG is in agreement with ComEd that the Commission should reject the City's proposal to apply regional surcharges that vary by county to electric delivery service rates: The AG argues that rate differences based on location would be arbitrary and unduly discriminatory." AG Ex. 6.0 at 7, 17, 19.

ComEd's contentions about plant investment, the allocation of costs between the City and non-City areas, and energy use patterns in City versus suburban customers seems to contradict ComEd witnesses' testimony who repeatedly stated that it is the cost of installing new outlying suburban facilities that justifies this rate increase. ComEd also described in detail that the costs of installing new facilities, especially underground cables, has risen dramatically.

We agree with ComEd that a regional surcharge to address the costs of new construction is problematic. However, in Pub. Act 95-0481 §1-5(4) (2007) the General Assembly stated that it is the policy of the State of Illinois that "investment in cost-effective energy efficiency and demand-response measures will reduce direct and indirect costs to consumers by decreasing environmental impacts and by avoiding or delaying the need for new generation, transmission, and distribution infrastructure." 220 ILCS 5/12-103(a).

The City argues that imposing costs on customers who use less energy is, at best, inconsistent with the General Assembly's mandate that reducing energy use is a vital policy objective of the State.

The Commission agrees. Customer costs are about 20% of the total cost of service. Because the allocation of customer billing costs, data management costs, installation costs, service drops, and customer information costs are assigned on the number of customers, residential customers currently pay 80% of them. These costs should be attributed as far as is practical to the cost causers. The record does not clearly establish that the costs identified by the City are necessarily related to usage.

v. Uncollectible Expense

The City next points out that the ECOSS allocates 38.4% of its uncollectible costs to low use, non-space heat, multifamily customers who account for 5% of energy sales, rather than spreading the cost across the board to all residential classes. A large proportion of City customers are in this class. The City argues that the theory behind this allocation is apparently that the Company has determined that a larger portion of uncollectible costs should be attributed to that class of customers who in the future may be most likely not to pay their bills based on past experience.

It is ironic that ComEd objects to allocating new facilities expenses on a geographic basis to the customers in the areas driving the request for a rate increase, but finds it appropriate that multi-family non-space heat customers should be charged for unpaid bills attributable to other delinquent multi-family customers. In any event, the

Commission finds that this allocation method is unfair and inconsistent with the allocation of other residential customer costs. We agree with the City in this instance.

vi. Customer Charge

The City proposes that the monthly customer charge should be reduced to $3 for low use single and multifamily customers to ease the burden on low income customers, many of whom reside in the City. ComEd argues that this proposal should be rejected because it is not cost-based. ComEd Ex. 32.0 Corr. at 25; AG Ex. 6.0 at 19-20. Fixed *per capita* customer charges result in a higher average cost per kWh for the low usage customer. Although the premise that low-income customers are low electricity use customers seems reasonable, the record however, does not demonstrate that low-income customers are necessarily low-usage customers, or vice versa. ComEd Ex. 32.0 Corr. at 25. Although prorating costs on the basis of usage generally encourages conservation and efficiency for all income levels, in this instance we believe that adhering to cost based allocation is reasonable.

There are other means in place that more precisely target the policy issue that the City seeks to address here. Specifically, the monthly charge to ComEd's customers for the State's Supplemental Low-Income Energy Assistance Fund is $0.40 for residential customers, $300 for customers with demands over 10,000 kW, and $4.00 for all other customers. *Id.* The Commission rejects the City's proposal that we reduce the customer charge to $3 for low use residential customers.

vii. Pre filed COSS

In its brief on exceptions, the CTA suggested that because of changes in the cost of service study mandated by this Order and because of the time limitations of rate cases, it would be helpful to the Intervenors if ComEd filed the new cost of service study sixty days prior to its next rate filing. In response, ComEd argues that this suggestion is untimely, impractical, contrary to the existing regulatory framework, and unnecessary.

viii. Rate Increase

ComEd argues that its ECOSS is reasonable and consistent with prior studies approved by the Commission. The Company insists that it is an appropriate instrument to use in determining rate increases.

Many of the Intervenors take issue with the proposed rates for various classes of customers. Specifically, members of the over 1 MW classes object to the proposed rate increase many times greater than the overall proposed increase of 21%. Representatives of these customer classes contend that the proposed rates change long standing cost relationships between classes without explanation. In ComEd's most recent previous delivery service case, Docket 05-0597, the ECOSS was not used for setting rates for large customers. In Docket 01-0423, the ECOSS was not used to allocate revenue to the non-residential classes, that received an across the board increase. In Docket 99-0117 classes were defined differently. Intervenors argue, the expanded use of the ECOSS in this case has not been validated by prior Commission approval on the contested issues in this case.

As stated above, the Commission finds that the ECOSS fails in several respects to properly allocate significant costs to cost causers and to correctly measure the cost of service to various classes and subclasses.

Staff urges that the Commission use an across the board increase instead of using the ECOSS and revenue allocation to determine rates. Staff says that this is the most reasonable approach to designing rates in this instance. All ratepayers have been stressed by recent significant increases in the cost of electricity. Staff believes that the bill impacts arising from this and other recent rate increases mandate an equal rate increase to all classes. There is no evidence in the record to show which group of customers can best afford the biggest increase. Staff believes that fairness requires this result.

The Commission disagrees with Commission Staff and many of the Intervenors that the fairest allocation in this case is an across the board increase. However, as we have noted, the substantial deficiencies in specific elements of the ECOSS render it problematic for purposes of rate setting in this docket. The Commission is keenly aware that ratepayers have been significantly impacted by recent electricity rate increases. The Commission is also aware that the greatest portion of those increases is due to the increase in commodity costs. The Commission is cognizant of the argument that an across the board increase exacerbates existing rate inequities, and agrees that, particularly in a period of rising prices, the elimination, or at the very least, significant reductions in rate inequities are a necessary condition to rate setting. What is unclear, and will remain unclear until an ECOSS is evaluated in compliance with our findings above, is how significant the rate inequities are under this ECOSS.

Nonetheless, the Commission is left to choose between two alternatives that are less than optimal; neither COSS allocates costs as accurately as we would like. In this instance, the Commission finds that an across the board increase not only goes against movement towards cost-based rates, but would exacerbate conflict between the classes and as such is inequitable for setting rates in this proceeding. Therefore, we accept ComEd's ECOSS with the following modification. Above, we determined that the proper assignment of primary and secondary distribution costs would likely reduce the total cost allocation to customers in the Extra Large Load, High Voltage, and Railroad delivery classes. It would be inconsistent with that finding to accept ComEd's two-step rate increase. Instead, an allocation that more closely reflects a proper cost of service would be reflected in a four-step, gradual movement toward rates based on the ECOSS for Extra Large Load, High Voltage, and Railroad Delivery Classes. ComEd Ex 30.0 at 43-45. Thus, the Commission authorizes a 25% movement toward ECOSS based rates for these customers, instead of a 50% movement.

IX. Rate Design

A. Overview

ComEd asks the Commission to approve its modified, proposed interclass allocation and rate design. ComEd asserts that it has employed cost-causation principles in an attempt to ensure that all customers are paying their fair share for

distribution service. To avoid rate shock, ComEd proposes a 50% movement toward its calculation of distribution facilities charges for the Extra Large Load Delivery Class, High Voltage Delivery Class, and Railroad Delivery Class at this time. If the Commission approves ComEd's proposals, these customer classes would be subject to a similar large rate increase in the next general rate case, thus eliminating what ComEd views as subsidies borne by the other nonresidential customer classes. Many of the Intervenors have suggested proposals to refine or correct perceived inequities in the proposed rate design.

B. Uncontested

The evidence supports ComEd's proposed revisions to the following existing tariffs: Rider ML, Rider SBO7, Rate MSPS7, and Rate BES-H. All parties agree with these changes. *See* Subsection IX.D.3 and 4. Therefore, the Commission finds these proposed revisions to be just and reasonable.

In addition, ComEd presents evidence supporting its proposal to update the proposed fees in the General Terms and Conditions using a methodology consistent with the methodology previously approved to determine the current charge in the General Terms and Conditions. ComEd Ex. 12.0, 18:321-19:336. ComEd's proposed charges in the General Terms and Conditions have not been challenged by Staff or Intervenors.

C. Contested

1. Residential

a) Residential Customer Charge

(1) City

The City provides testimony that rate design is used when there are appropriate reasons to deviate from the cost of service established in a case. City Ex. 1.0 at 79:1449-51. Mr. Bodmer recommends that even if the Commission rejects his proposals to modify ComEd's cost study, the Commission should reduce the monthly customer charge at $3 per customer. Mr. Bodmer explains that "[b]oth low-use single-family and multi-family ratepayers in the City tend to have characteristics that lower ComEd's distribution costs, such as higher density, older plant and less undergrounding. Thus, the customer cost and customer charge for such ratepayers should be lower, appropriately moving costs from low- to higher-use ratepayers." *Id.* at 79:1461-66.

(2) ComEd

In response, ComEd claims that an analysis conducted by Mr. Alongi and Dr. Jones dispels Mr. Bodmer's contention that low-use customers are necessarily low-income customers. ComEd Init. Brief at 105. Mr. Alongi and Dr. Jones presented a graph and a table that they assert undercuts Mr. Bodmer's claim. The City notes that the graph they present merely shows there are low-use customers who live in high-income areas. There is no analysis – nor can there be any conclusion – that the low-use customers in the areas that Mr. Alongi and Dr. Jones examined are not low-income

customers. *See* Tr. at 2124-25. ComEd argued that the proposed reduction is not cost based.

There are other means in place that more precisely target the policy issue that the City seeks to address here. Specifically, the monthly charge to ComEd's customers for the State's Supplemental Low-Income Energy Assistance Fund is $0.40 for residential customers, $300 for customers with demands over 10,000 kW, and $4.00 for all other customers. *Id*. at 25:427-26:429.

(3) Commission Analysis and Conclusion

The City proposes that the monthly customer charge be reduced to $3 for low use single and multifamily City customers because of lower usage and lower cost of service. ComEd argues that this proposal should be rejected because it is not cost-based. ComEd Ex. 32.0 Corr. at 25; AG Ex. 6.0 at 19-20. Fixed per capita customer charges result in a higher average cost per kWh for the low usage customer. Although the premise that low-income customers are low electricity use customers seems reasonable, the record does not demonstrate that all low-income customers are necessarily low-usage customers, or vice versa. ComEd Ex. 32.0 Corr. at 25.

We agree with ComEd -- the monthly charge to customers for the State's Supplemental Low-Income Energy Assistance Fund addresses this concern. Thus, the Commission rejects the City's proposal that we reduce the customer charge for residential customers to $3. In this instance we believe that adhering to cost based allocation is reasonable.

2. Non-Residential

a) Space-heating customers

(1) BOMA

BOMA presents evidence in these proceedings of to support its allegation of rate shock experienced by users of the former Rider 25. BOMA contends Rider 25 was unlawfully eliminated in Docket 05-0597, and the elimination has never been justified on the basis of cost studies.

Most recently in Docket 07-0166, the Commission declined to provide a remedy to the former Rider 25 customers primarily due to the lack of independent cost studies and verification of rate impacts incident to the elimination of Rider 25. Docket 07-0166, Order (Oct. 11, 2007).

In the instant proceeding, BOMA provides evidence that the larger non-residential customers have received the largest rate increases since the advent of electric competition on a bundled and unbundled basis. *See*, BOMA Ex. 2.2. In constructing this analysis, BOMA uses ComEd's own posted rates, schedules and load profiles. BOMA Ex. 2.0.

Although BOMA maintains that ComEd bears the statutory duty of justifying the elimination of Rider 25 (*see* 220 ILCS 5/16-103), BOMA has provided analyses of the rate impacts experienced by the former Rider 25 customers and suggests that in

ComEd's current and past rate design structures, former Rider 25 customers subsidize non space heating customers.

In fact, BOMA presents exhibits and testimony attempting to show that the cost of service for space heating customers is always lower than for non-space heating customers. According to BOMA's analyses, non-residential space heat customers have received the largest increases in ComEd rates since the inception of electric deregulation, both in terms of distribution rates and bundled rates. BOMA Ex. 2.2 (Corr.). For the larger non-residential customers, the percentage distribution rate increased precipitously; to a high of almost 55% (for the former 800kW – 1000kW class). In contrast, residential customers received increases during the relevant time period of only 0.27% for single family non-space heating customers and 6.11% for single family space heating customers; Multi-family residential customers actually experienced decreases in distribution tariffs. BOMA Ex. 1.0 Corr. at 7.

Similar to BOMA's analysis of purely distribution rate increases, BOMA submits its Corrected Exhibit 2.2 which shows analogous percentage increases in bundled rates for the period of 1999 to 2007. According to BOMA's exhibit, which uses ComEd's own rates and profiles, non-residential space heat customers incur the largest increases, up to approximately 85% for the 1,000 – 3,000 kW class. *Id.* Also consistent with distribution percentage rate increases, residential customers receive lower bundled rate increases for the same time period, between 15% and 28%. *Id.* This evidence is consistent with evidence submitted by BOMA in Docket No. 07-0166. Docket 07-0166, Order at 18.

BOMA states that its analysis measures the "increases in ComEd rates using the designated default service rate for each customer class…" BOMA Ex. 4.0 at 5. The use of Rate BES-NRA in the analyses of bundled rate increases for the 400 kW to 3,000 kW demand classes was appropriate since this rate would have automatically been assigned to customers residing in those classes had they not actively chosen an alternative rate or third party supply service. *Id.* Further, BOMA witness Sharfman illustrates in rebuttal testimony and associated BOMA Exhibit 4.1 that "the vast majority (approximately 86%) of customers residing in the 400 kW to 3,000 kW demand range that remained on ComEd supply service" (BOMA Ex. 4.0 at 6) took service on Rate BES-NRA as opposed to Rate BES-H. Obviously, many customers were unsatisfied with the default rate and, at least those customers with reasonable credit or who were paying attention, migrated to alternative supply options. *See*, *Id.* at 5.

BOMA asserts that assessing lower distribution charges to electric space heat customers relative to non-space heat customers is a common practice in the electric industry. BOMA Ex. 4.0 at 8. Many utilities across the country differentiate distribution charges between space heat and non-space heat customers within the same class. *Id.* at 8; ComEd Ex. 45 at 12.

BOMA argues ComEd's embedded cost of service study provides for a significant deviation in the revenue requirements between the residential customer classes. *See* ComEd Ex. 13.1. In fact, residential space heating customers have a significantly lower cost of service on a per unit basis (both kWh and kW). BOMA Cross Ex. 2.

BOMA asserts that the differentials between ComEd's proposed annualized structure of determining revenue requirements, coupled with the rate design application of ComEd's proposed (and current) monthly billing of maximum kilowatt demand ("MKD"), an inference that can be made is that the cost of service differentials similarly exist in the non-residential customer classes and that electric space-heating customers subsidize non-space heating customers.

As a potential remedy, BOMA proposes that former Rider 25 customers receive a reduced economic incentive to leave the electric distribution system through the implementation of a two-block demand charge available during months when electric space-heating would normally be used by these buildings. BOMA Ex. 5.0 at 14. BOMA's alternative recommendation solution is for the Commission to initiate a proceeding or re-hearing to address Rider 25 issues and remedies. BOMA Ex. 5.0 at 16.

BOMA argues that relief from the disproportionate rate impacts imposed by ComEd's elimination of Rider 25, and ComEd's continuing reluctance to distinguish between non-residential space heat and non-space heat customers is well overdue.

(2) ComEd

ComEd argues that the Commission should again reject the request to establish a separate rate class for nonresidential electric space heat customers. ComEd stated that the Commission already addressed BOMA's arguments in Docket 05-0597 and Docket 07-0166. As evidenced by its very elimination, ComEd asserts that former Rider 25 is a vestige of the past and does reflect ComEd's transition to a delivery company. ComEd further states that BOMA's request to establish a separate, subsidized class of distribution charge for nonresidential electric space heat customers should be rejected because there is no evidence to show that the costs of providing distribution service are somehow different for nonresidential electric space heat customers.

(3) Commission Analysis and Conclusion

BOMA again requests that a separate class for nonresidential electric space heat customers be established. BOMA Ex. 1.0 Corr. at 10-11. BOMA's request was rejected in the last rate case. Docket 05-0597, Order at 217-19 (Jul. 26, 2006).

Before the divestiture of ComEd's power generating assets, ComEd's former Rider 25 provided a subsidy to nonresidential electric space heating load customers in the form of a specific energy charge with no demand charges in the non-summer months. Rider 25 was created at a time when the cost of power supply from ComEd's then existing generation was significantly lower in the off-peak seasons. ComEd argues that conditions have changed as a result of deregulation. ComEd no longer has generating capacity and Rider 25 has been eliminated. Supply charges are not the subject of this proceeding. There is no evidence that delivery service costs vary seasonally. The record shows that distribution facilities must be planned and built to meet customers' maximum loads, regardless of when those may occur. There is no basis in this record to conclude that it costs ComEd less to serve nonresidential customers who use some of their electric service for space heating. Nor, is there a public policy issue which would justify a deviation from a cost causing allocation.

The Commission rejects BOMA's proposal to establish a separate class or distribution charge for nonresidential electric space heat customers. The Commission finds that customers in the non-residential space heating rate class shall be subject to the same general rate increase as other rate classes.

b) Railroad customers

(1) Power Supply Issue

(a) ComEd

ComEd argues that it has shown that it does not need Metra or CTA traction power substation facilities, which are attached to ComEd's system, to provide reliable service to any customer, and that only under extremely unlikely circumstances would the facilities be used to furnish power to a customer who otherwise might be without service. ComEd Ex. 21.0 Corr. at 107-110. Thus, ComEd avers that Metra and CTA do not deserve preferential rate treatment on this basis.

ComEd agrees that some of the railroads' traction power substations are powered by more than one ComEd feeder circuit, but notes that this configuration was requested by the railroads for their own benefit. Tr. at 1418–19; Tr. at 1438–39. ComEd explains that under normal operating conditions, with both feeder circuits in service, both the railroads and other customers on the feeder circuits receive power. It states that power may, as a function of the laws of physics, flow between the feeders depending upon the electrical characteristics of the system at that time. ComEd Ex. 21.0 Corr. at 112. However, ComEd asserts that if a fault occurs on one of the circuits, the railroad's system would (automatically) open a circuit breaker, cutting it off from the circuit with the fault, and maintaining its power from the unaffected circuit. ComEd's witness says that this open breaker would not restore or maintain power to any of ComEd's customers. *Id.* at 109. Further, ComEd states that the closed loop feeder configuration is not an optimal way, from its perspective, to serve an individual customer, and has not used that configuration to serve a new customer for many years. ComEd Ex. 36.0 at 502-510.

ComEd cites the Commission's decision in its most recent rate case, Docket 05-0597, in which the Commission held that "[w]hile it is true that physics dictate the flow of electrons on the ComEd/CTA distribution system, the CTA has not proven that its equipment, either by design or by chance, improves the reliability of ComEd's system or allows ComEd to avoid incurring costs." Docket 05-0597, Order at 255. ComEd states that the facts have not changed, and no valid reason has been provided as to why the decision should change.

(b) CTA

At one time, many of the CTA traction power substations were owned and operated by ComEd as part of its distribution network. Therefore, it was reasonable for ComEd to originally design them so that power could flow through the substations to serve other ComEd customers. However, over the past half century, the CTA has acquired many of its traction power substations from ComEd, built several more and now operates and maintains all traction power substations.

Each CTA traction power substation is a “point of supply” under the CTA-ComEd contract. Traction power is delivered to each of the 61 CTA traction power substations at 12 kV AC. At the point of delivery, the power is measured by a remote AMR meter that provides the energy and demand information to ComEd over each substation’s telephone line. The equipment in the traction power substation is owned and operated by the CTA. There are CTA circuit breakers on each of the two lines that feed the substation. The breakers are operated in the closed position; that is, power can flow into the CTA substation from either Circuit A or Circuit B or form both at the same time. It is only when the circuit breaker is in the open position that power cannot flow.

CTA argues that it has shown that power does flow through the CTA traction power substation to serve other ComEd customers in several ways. ComEd itself confirms that it plans for flow-through power using the CTA traction power substations in its notations on the Company’s own one-line diagrams, two of which were introduced into evidence.

The CTA receives no compensation from ComEd for the use of the traction power substations to assist ComEd in serving its other customers. Certainly few, if any, other customers of ComEd provide this type of uncompensated service for ComEd.

(c) Metra

There is a substantial amount of conflicting testimony in this proceeding concerning the operational and reliability benefits provided to ComEd and other ComEd customers due to the connection of dual ComEd feeder lines at Metra and CTA substations via a tie breaker. To address this, Metra requests that ComEd be directed to conduct a load flow study of ComEd’s use of the Railroad Class facilities to serve other customers.

(d) Commission Conclusion and Analysis

Metra and CTA suggest that their rates should be lower because they claim that ComEd relies on their traction power substation facilities, which are attached to ComEd’s system, to serve other customers. The CTA raised the identical argument in ComEd’s most recent rate case, but the Commission rejected it. Docket 05-0597, Order at 254-55.

The evidence that ComEd uses power flowing to Metra or the CTA to furnish power to another customer who otherwise might be without service, is conflicting. Many, if not all, of the railroads’ traction power substations are powered by more than one ComEd feeder circuit – a configuration ComEd contends was requested by the railroads for their own benefit. Tr. at 1418–1419; Tr. at 1438–1439. Under normal operating conditions, with both feeder circuits in service, both the railroads and other customers on the feeder circuits receive power. Power may, as a function of the laws of physics, flow between the feeders depending upon the electrical characteristics of the system at that time. ComEd Ex. 21.0 Corr. at 112. ComEd insists that the extra circuits would not restore or maintain power to any of ComEd’s customers. ComEd Ex. 21.0 Corr. at 109.

The CTA and Metra demonstrate that power could flow through the CTA traction power substation to serve other ComEd customers. There are two meters at each substation. Each individual meter can be viewed at the same time. If power is flowing out of the substation, the demand is reflected as a negative number. The CTA presents evidence that meters at traction power substations show power flowing into the substation on one meter and out of the substation on the other meter.

The Commission finds that the evidence does not prove that railroad facilities are essential to reliable service of ComEd's customers, and does not justify preferential rate treatment on that basis at this time. However, the evidence presented by CTA and Metra was sufficient to warrant further study. Metra has requested a load flow study to determine this question. ComEd says the study should be called a contingency study. The Commission directs ComEd to consult with the CTA and Metra to conduct an appropriate study to determine whether and (if so), how much ComEd uses or needs Railroad Class facilities to serve other customers. The results and conclusions of this study should be presented to the Commission in ComEd's next rate case.

(2) Public Policy and the Railroad Class

(a) ComEd

ComEd states that its proposed rate design fairly treats all customers, including those who provide service, that is in the public interest and there is no reason to provide special rate treatment to Metra and the CTA. ComEd acknowledges that the Commission made certain statements in its Order in Docket 05-0597 regarding the impact of rate increases on the railroads. However, ComEd interprets that Order as not requiring it to implement any changes in future rate cases. ComEd characterizes the statements in the 05-0597 Order as "public policy" statements that do not alter the Commission's authority in this rate case proceeding; which is to (a) establish rates that are just and reasonable and (b) ensure that the rates do not unduly discriminate between customers and customer classes. *See* 220 ILCS 5/9-101, 5/9-241.

ComEd argues that the Commission should approve its proposed rate design, because it sets rates in a manner that does not unduly discriminate in favor of, or against, any groups or types of customers. Moreover, ComEd states that its proposed rate design will not place ComEd or the Commission in the untenable position of picking worthy causes and requiring that other customers subsidize use of the electric distribution system. In particular, it is ComEd's position that it would be inappropriate to arbitrarily set the public interest value of public transportation over other entities that promote the public interest, such as hospitals, universities, churches, homeless shelters, government buildings or even businesses and industries that support job growth. Indeed, if the Commission accepts the Railroads' proposal, those other public interest entities will be placed in the position of subsidizing the Railroads rates.

(b) CTA

On an annual basis there are 430 million rides taken on the CTA. As a provider of mass transit, the CTA uses energy efficiently and helps conserve a vital national resource. In a time of $5 a gallon gasoline prices, the Commission must avoid any action that would have an adverse effect on mass transit.

In Docket 05-0597, this Commission said it:

> must consider the potential adverse impact of utility rate increases on entities that provide public transportation. The Commission desires to encourage the efficient use of energy and conservation of scarce resources. Docket 05-0597, Order at 190.

ComEd states that the Commission's public policy statements were considered, but that ComEd "based our rates on the Cost of Service Study and the public policy considerations that we undertook – that we went through when we were designing the rates." Tr. at 1132:20-22. In addition, ComEd admits that no facts had changed between December 2006 and October 2007 filing of this rate case that would cause the public interest considerations identified in Docket No. 05-0597 to be inapplicable. Tr. at 1138:2-9. Nonetheless, ComEd proposes an increase of 124% for the Railroad Class while seeking a system wide increase of roughly 20%. Such a dramatic increase blatantly ignores the Commission's public policy findings in Docket 05-0597.

The benefits provided by the CTA for efficient use of energy and conservation of scarce resources have not diminished since Docket 05-0597. If anything, in today's economic environment and oil price run-up, the benefits are more pronounced. As CTA's Mr. Anosike testified, "[M]ass public transit is an important tool for not only conservation of energy but also provides a positive economic impacts and environmental benefits." CTA Ex. 1.0 at 8. Americans use more energy for transportation than for any other activity.

Not only is public transit more efficient for transporting people than private automobiles, a fully loaded CTA train can take hundreds of cars off the road. This also has a positive environmental effect as well, because public transportation produces half as much emissions per passenger mile as automobile trips.

In response, ComEd argues that one of the benefits of its "Smart Grid" proposal is to "[r]educe the distribution utility's own environmental impact" by using Smart Grid to "substantially reduce the vehicle miles need to read and manage meters." ComEd Ex. 15.0 at 9. Thus, the CTA finds it odd that ComEd believes total energy usage and conservation should not be considered by the Commission in setting rates.

The CTA believes the Commission should reaffirm its policy declarations from Docket 05-0597 to support efficient energy use and protect the users of mass transit from the effects that a 124% increase in delivery service charges by ComEd would impose. In addition, these contractual and public policy concerns should be required to be taken into consideration by ComEd in all of its future rate case filings before this Commission. The CTA urges the Commission to take these considerations into account and direct the Railroad Class and ComEd to jointly perform the class specific cost identification study.

(c) Metra

In the last rate case, the Commission specifically found that public interest considerations warranted keeping the increase in the rates to the Railroad Class to a minimum. Docket 05-0597, Order at 189-90. The Commission found that ComEd's

proposed rate increases to the Railroad Class in the last case failed to take into account the important public policy considerations associated with the rates charged public transportation providers:

> ComEd's proposal fails to account for the potential impact of increased utility rates for entities providing public transportation on the citizens of Illinois. In the 05-0597 Order the Commission stated that it must consider the public policy implications of establishing delivery rates that encourage energy conservation and encourage electric usage during off-peak periods. *Id.* at 190

The Commission also reiterated these concerns in rejecting ComEd's proposal to change the ComEd contracts with the Railroad Class to eliminate the Railroads' right to aggregate their demand for purposes of calculation of the Railroad Class distribution facilities charges.

The Commission also found that minimizing the change to existing contractual terms as necessitated by the post-2006 market changes, as well as avoiding rate shock to the railroad customers, was in the public interest. *Id*. at 190. The Commission specifically recognized that its order requiring ComEd to abide by the existing contract's terms might create a subsidy. The Commission observed that this arrangement follows the aggregation of demand under the existing CTA and Metra contracts:

> To the extent that the aggregation creates or otherwise represents a subsidy to the railroad class, the difference in cost should be recovered from the other non-residential classes." *Id*.

Metra argues that when ComEd filed its proposed rates in this case, in which it sought to increase the Railroad Class' rates by 124%, it elected to defy the Commission and ignore its most recent policy guidance. Metra contends that ComEd has elected not to follow the Commission's policy guidelines issued in the last case because ComEd disagrees with them.

Contrary to the Commission's most recent decision, ComEd argues in its brief that those benefits are irrelevant and should be ignored. That is an inconsistent position for ComEd to take, given that one of the key reasons that ComEd cited to support adoption of Rider SMP were the environmental benefits resulting from Smart Grid Technology. Tr. at 466-468. Environmental benefits are important public policy considerations that can and should be taken into account in rate-making.

Unless there are clear and distinguishable reasons for deciding a case differently, the Commission should follow precedent. To do otherwise risks a charge of arbitrary and capricious action, citing North Shore Gas Co., et al., Dockets 07-0241/07-0242 Consol., (Order dated Feb. 5, 2008). Metra believes that the public interest considerations that the Commission took into account in the last rate case are even more significant in the current era of gasoline prices that are well in excess of $4 per gallon, and therefore, are entitled to the same consideration afforded by the Commission in this rate case.

Metra urges the Commission to approve an average, across-the-board increase for all customer classes or to set the Railroad Class' rate increase at either the average increase for all rate classes or the average rate increase for the residential classes.

(d) Commission Analysis and Conclusion

Metra and the CTA argue that the ECOSS ignores the Commission's explicit recognition in its last rate case that minimizing the impact of higher electricity rates on mass transit providers is desirable. Docket 05-0597, Order at 189-190. ComEd's position is that it would be inappropriate to arbitrarily set the public interest value of public transportation over other entities that promote the public interest.

We agree with Metra and the CTA that the proposed rates for the railroad class ignore this recent directive from the Commission. In this case, ComEd originally proposed rates for the railroad class that were more than five times that of the general increase. Even under its mitigation plan, the proposed rates for the railroad class are three times higher than the general increase. Thus the ECOSS, which the Commission has found to be inaccurate in several respects relevant to the railroad class, directly conflicts with our finding in Docket 05-0597 that minimizing rate shock to railroad customers is in the public interest.

Our commitment to a policy of encouraging conservation, efficient energy use and the environmental benefits of affordable public transportation has not lessened since the July 26, 2006 Final Order in Docket 05-0597. We find that the modified rate proposal fails to comport with our explicit direction in the last case to avoid rate shock to the railroad class. Docket 05-0597, Order at 190. We direct ComEd to take this policy directive into account in preparing for the next rate case.

(3) The CTA Contract with ComEd

(a) ComEd

ComEd states that the Commission should not take the CTA's contract into account in setting rates for the Railroad Delivery Class because it is beyond the scope of the Commission's authority in this rate case proceeding. *See* 220 ILCS 5/9-101, 5/9-241. Even if the Commission were to recognize the existence of the contract in some fashion in setting rates in this proceeding, ComEd argues that the Commission would also have to consider the numerous modifications to the contract over the years. ComEd notes that such modifications include ComEd's filing after the last rate case of Rate BES-RR, revised sheets in Rate RDS, Rider NS, Rider ML, and ComEd's General Terms and Conditions. ComEd also notes that another change not reflected in current contracts is that the CTA no longer takes electricity supply from ComEd. Accordingly, ComEd urges the Commission to continue to find that ComEd's contracts for electric service with its two railroad customers are subject to modification pursuant to Commission Orders. In addition, ComEd requests the Commission to find that its tariffs, filed in compliance with Commission Orders or legislation, serve to amend the railroad contracts without explicitly changing the language of the railroad contracts.

(b) CTA

The CTA entered into a written contract with ComEd in 1958 and amended said contract in 1998. CTA asserts that the contract is far broader than just rate matters. CTA explains that it has provisions that allow ComEd to use CTA right of way for ComEd's distribution lines to its other customers, establishes who is to pay for various customer-related costs and provides for arbitration of disputes between the parties. In 1958, many of the then-existing traction power substations were owned and operated by ComEd. Over the years, most of the 1958 vintage traction power substations have been transferred to the CTA. New traction power substations have been built by the CTA.

One of the benefits, to ComEd, of the written contract is ComEd's ability to use the CTA's elevated track structures to hang many miles of ComEd cables and wires that are used to serve not the CTA but rather ComEd's other customers. In addition, ComEd is able to install poles, conduit and ductwork within and under the CTA's rights of way. This is a benefit to ComEd for which the CTA receives no separate compensation but rather was negotiated as part of the over-all contract between the two entities. It is but one of the many *quid pro quo* provisions in the written agreement between the CTA and ComEd. If ComEd insists on unilaterally rewriting the CTA-ComEd contract (which the CTA contends violates the United States and Illinois Constitutions), then the Commission must give consideration in the CTA's rate for providing this free right of way to ComEd when its sets rates.

The CTA argues that in Docket 05-0597 and continuing in this docket, ComEd erroneously asserts that it has the unilateral right to change any contract term it wants without consulting the CTA. The CTA notes that the Commission itself decried this practice in the last case, noting that "the Commission takes contractual obligations seriously and tries to leave them in tact [sic] whenever possible." Docket 05-0597, Order at 189. In fact, the Commission expressed puzzlement as to why ComEd has not entered into a new contract with the CTA when it found "the Commission would have expected ComEd to negotiate a new contract for the delivery of power and energy with the CTA and present it to the Commission for approval." Docket 05-0597, Order at 188.

Instead, according to the CTA, ComEd files first with the Commission, then argues it is "negotiating" when it first presents an unreasonable rate, as it did here. It then offers to "mitigate" the rate impact by cutting its original proposal by 50%. ComEd argues that it cannot renegotiate the CTA-ComEd contract because of 83 Ill. Adm. Code 452.230. If that is correct, then ComEd cannot, by filing tariffs, do indirectly what it is prohibited from doing directly. The Commission should restate its desire for ComEd to negotiate its contract with the CTA as the Commission expected it to do prior to filing Docket 05-0597.

The CTA believes this Commission must continue to recognize the contractual provisions between ComEd and the CTA that remain in full force and effect. Moreover, the CTA asserts that the Commission is prohibited by the Illinois Constitution, Art. I. Sec. 16 and U.S. Constitution, Art. I, Sec. 10 from abridging these contractual rights

through its orders. *United States Trust Company of New York v. New Jersey et al.*, 431 U.S. 1, 17 (1977). Instead, the Commission should continue its practice of keeping the contracts intact.

The CTA's position is that not only does the CTA-ComEd contract provide right of way and structures for ComEd to place its poles, conductors, ductwork and lines, but also supports the reliability of ComEd's system because the CTA traction power substations at each location connect at least two separate ComEd circuits allowing through-flow to server other ComEd customers.

(c) Commission Analysis and Conclusion

In an above section, the Commission has directed ComEd to conduct a study to determine whether and (if so), how much ComEd uses Railroad Class facilities to serve other customers. We expect the results of that study will provide all concerned with an answer to that question so that a value for those services can be computed in future rate cases. The Commission finds it likely that the provisions of the contract reflect certain rights and concessions that ComEd and the CTA have made regarding the use of CTA facilities. As the Commission noted in the final Order in Docket 05-0597, these contracts are useful for purposes unrelated to rate design. ComEd is directed to follow the provisions of its contract with the CTA to the extent that it is not superseded by Orders of the Commission. Because Metra has a similar contract with ComEd, this directive also applies to the Metra contract with ComEd. As the Commission noted in its Order in Docket 05-0597, at page 188, we expect ComEd to negotiate updated contracts with the railroad class for the delivery of power.

c) Primary and Secondary Billing Proposal

(1) DOE

Some customers who take service at 69 kV or higher also have separately-serviced load at standard voltage. The Company bills such "combined" loads in their entirety at high voltage rates. Obviously, these high voltage rates are lower than the rates at which these customers' separate lower-voltage loads would otherwise be billed. This creates a subsidy from high voltage customers who do not have such separate loads to high voltage customers who do. When DOE raised this matter, the Commission directed the Company to isolate these standard voltage loads and bill them separately. Docket 05-0597, Order at 44. It then temporarily suspended that directive, to enable the Company to get new rates into effect quickly. Docket 05-0597, Order on Rehearing at 66 (Dec. 20, 2006). That directive, to isolate the standard voltage loads and bill them separately, is thus still in effect. The Commission should order the Company to bill each such separate standard voltage load at whatever rate it would be under if the customer did not also take at high voltage. This change would affect only 28 high voltage customers, and the Company already does similar separate billing of separate loads.

(2) IIEC

IIEC states that both it and the DOE have made billing proposals that would effectively isolate the standard voltage load from high voltage load for customers in the

High Voltage Delivery Service Class. According to IIEC, distinguishing between standard voltage load and high voltage load for these customers would result in a more equitable treatment of the customers within the High Voltage Delivery Service Class. It would also eliminate any reason to allocate a portion of the lower voltage system to these high voltage customers in the ECOSS.

Under ComEd's present rate structure, customers taking service at 69 kV and above are in the High Voltage Delivery Service Class. IIEC claims that approximately one-half of these customers also have some electrical load at their plant or business locations that receive service at voltages below 69 kV. Under the High Voltage Delivery Service Class structure implemented by ComEd in the delivery service rates approved by the Commission in the Company's last delivery service rate case, ComEd has billed high voltage delivery service customers as if their entire load was served at high voltage. Because of this new rate class structure, ComEd allocates a portion of the primary and secondary delivery system, *i.e.*, below 69 kV, to the High Voltage Delivery Service Class. IIEC claims that this is a significant flaw in ComEd's ECOSS, and, as a result of this flaw, all customers in the High Voltage Delivery Service Class pay for a portion of the primary and secondary system, whether or not they have any service below 69kV. IIEC's proposals would allow these customers to be properly billed in accordance with cost causation, according to IIEC, and it would eliminate any artificial rationale for allocating any portion of a lower voltage system to these high voltage customers.

IIEC posits that because tariffs in the last case had to be in effect on January 2, 2007, the Commission's December 20, 2006 Order on Rehearing allowed ComEd to eliminate the service voltage distinction in its tariffs "to facilitate implementation by January 2, 2007" of the new tariffs. However, there is no indication in the Order on Rehearing that the expedited arrangement was to be permanent, or was to extend beyond the duration of the January 2, 2007 rates.

IIEC's billing approach would establish a separate surcharge that, IIEC believes, would allow ComEd to collect applicable delivery service charges for the relatively small portions of the High Voltage Delivery Service Class loads that are not served at high voltage. However, IIEC claims that its approach would not require customer accounts to be split into two separate rate classes, as ComEd has claimed, and notes that ComEd uses a similar approach in its current Rider ZSS-7 and does so without creating separate delivery classes, and previously charged high voltage customers in this manner prior to 2007, through a credit for service at high voltage (only) under its Rider 11 and its Rider HVDS. IIEC states that, due to the similarities in the effect of their proposals, IIEC would not object if the DOE approach is approved by the Commission instead of IIEC's.

(3) ComEd

ComEd urges the Commission to reject the requests by DOE and IIEC. Whereas DOE proposes that ComEd charge two separate distribution facilities charges to customers in the High Voltage Delivery Class that are served at multiple points with some lines entering the premises at voltages below 69kV, IIEC proposes that ComEd implement a surcharge for the load of high voltage customers served at lower voltages.

ComEd states that both proposals should be rejected, because implementation would be very difficult and complex and is simply not warranted for the small portion of the billing demand that would be impacted by either proposal. ComEd Ex. 45.0 at 14-15.

(4) Commission Analysis and Conclusion

The DOE and IIEC recommend that customers in the High Voltage Delivery Class served at multiple points with some lines entering the premises at voltages below 69 kV be assigned to two delivery service classes. DOE Ex. 1.0 at 25. They note that the Commission ordered ComEd to do this in Docket 05-0597 (at 199). This requirement was subsequently temporarily suspended at ComEd's request on rehearing for the limited purpose of facilitating new rates on an expedited basis. Docket 05-0597, Order on Rehearing at 67.

ComEd argues that by assigning two delivery service classes to the same customer, DOE is essentially recommending that ComEd create two distinct customers for each high voltage customer that has some electric lines entering the premises at voltages under 69 kV. ComEd also argues that its systems are not structured in a manner that would allow the application of two distinct demand-based delivery classes to a single customer. ComEd contends that such a separation is not necessary because less than four percent of the billing demand for the High Voltage Delivery Class is even served at voltages under 69 kV.

DOE says it is not suggesting that this creates two customers, it is suggesting two rates for the same customer. DOE's witness argued that to avoid two delivery demand calculations and moot one of ComEd's criticisms of the proposal, the customer charge and the meter servicing charge for the class of service that makes up most of the customer's load be used for both the high and low voltage loads of the 28 customers in this class. IIEC proposes that ComEd implement a surcharge for the load of high voltage customers served at lower voltages. Alternatively, IIEC is willing to accept the DOE proposal.

ComEd does not argue that it lacks the metering data to make this calculation. The billing change would eliminate any subsidy from strictly high voltage customers to those high voltage customers who take part of their service at lower voltages. IIEC indicates that it has no objection to implementing the DOE suggestion on this issue. In its Brief on Exceptions, ComEd argues that the cost of this modification be absorbed by this rate class and that there be no differentiation in charges based on the preponderance of the voltage load for the customer. The Commission rejects ComEd's suggestions. The Commission finds the modification proposed by DOE, regarding the billing of secondary voltage service to High Voltage Delivery Class customers, to be reasonable and order ComEd to incorporate it in its bills to these customers.

D. Existing Riders

1. Rider ACT

a) Staff

Staff, in its direct testimony (Staff Ex. 8.0 at 16-21) opposes one of ComEd's proposed changes to existing Rider ACT – Allowance for Customer-owned

Transformers. Specifically, Staff opposes the mandatory removal of customers from Rider ACT who had received more than 30 years of credit. In rebuttal testimony, ComEd stated it was willing to accept Staff's position. ComEd Ex. 32.0 at 41. With ComEd's acceptance of that change, Staff would note that there are no contested issues with regard to Rider ACT. Staff found the remaining ComEd proposed changes to Rider ACT to be acceptable.

b) DOE

DOE has no objection to the modified proposal.

c) REACT

REACT maintains that ComEd has not justified its proposal to eliminate or close Rider ACT. ComEd attempts to blame the customers who take service under Rider ACT for creating an inconvenience for ComEd. REACT notes the oddity of that approach – obviously, it is not the Rider ACT customers' fault that Rider ACT exists. REACT also notes the oddity of ComEd's articulation of its argument in the present tense, complaining about customers that "choose" to use their own transformers. REACT points out that ComEd's approach tries to direct attention away from the fact that many Rider ACT customers have owned their own transformers for decades. According to REACT, to suggest that those customers are making some contemporary decision to "choose" service under Rider ACT is absurd – for the vast majority of such customers, they chose (past tense) to take service under Rider ACT many years ago, and ComEd cannot change that fact through subtle choice of words. Thus, REACT argues that ComEd's word play is insufficient to satisfy the burden of proof that is squarely on ComEd to justify its proposal.

REACT explains that even in spite of its revised proposal on Rider ACT, ComEd still fails to justify any proposed revisions to Rider ACT. It is not sufficient for ComEd simply to assert, without any proof, that a particular rate is inconvenient, especially when ComEd apparently admits that Rider ACT better reflects the cost of serving these customers. Thus, REACT argues that if the Commission determines that it is appropriate for ComEd to make changes to the existing Rider ACT, then the proposal to remove the mandatory termination provision, close Rider ACT to new customers, and offer a voluntary termination provision is more appropriate than ComEd's original proposal. *See* REACT Ex. 5.0 at 27.

REACT further states that notwithstanding its revised proposal, ComEd still has failed to justify any proposed revisions to Rider ACT.

REACT requests that the Commission order ComEd to retain Rider ACT, and further states that if the Commission determines that it is appropriate for ComEd to make changes to the existing Rider ACT, then the proposal to remove the mandatory termination provision, close Rider ACT to new customers, and offer a voluntary termination provision is more appropriate than ComEd's original proposal.

d) Commission Analysis and Conclusion

ComEd agreed to make incentive payments to customers who choose to terminate service under this Rider. These payments would not be made if the Rider

continues to exist. Very few customers have chosen to use this Rider in recent years; therefore, eliminating it for new customers will not create a hardship. We reject REACT's objection and approve the modified proposal to close service to future customers under the terms of the rider. Accordingly, the Commission finds ComEd's revised proposed Rider ACT to be just and reasonable.

2. Rider AC7

Rider AC7 compensates residential customers for reducing load by permitting ComEd to install a direct load control ("DLC") device that cycles their central air conditioning unit compressor. Approximately 56,000 residential customers are currently taking service under Rider AC7, which translates into nearly 55 MW of demand response from this customer group.

ComEd proposes a ratemaking adjustment to its delivery service revenue requirement needed to reflect the revenues stemming from Rider AC7 – Residential Air Conditioner Load Cycling Program 2007 ("Rider AC7") at current compensation levels. ComEd proposes to reduce the Illinois-jurisdictional revenue requirement by just under $500,000 in order to reflect the difference between the market value of the capacity in the PJM market and the compensation payments made to residential customers enrolled in Rider AC7 (for the ability to cycle or interrupt the compressor on air conditioning units).

In its direct testimony, CUB proposes an adjustment to the revenue requirement related to Rider AC7. ComEd argues that it demonstrates that CUB's adjustment should be rejected because it applies to time periods that extend well beyond the period for pro forma adjustments.

CUB did not present rebuttal testimony addressing this alleged flaw, nor did it discuss this issue in its briefs. Accordingly, the Commission approves ComEd's ratemaking adjustment to its delivery service revenue service requirement to reflect the revenues streaming from Rider AC7 as proposed.

3. Rider ML [and Rider SBO7] (Uncontested)

ComEd proposes to reduce the embedded cost-based single bill credit from $0.63 per bill to $0.54 per bill. ComEd's proposed reduction under Rider SBO7 has not been challenged by Staff or Intervenors. Staff does not oppose the proposed ComEd language changes to Rider ML – Meter-Related Facilities Lease.

It is Staff's understanding that during the course of providing answers to Staff data requests on this issue and others (*see* Rate MSPS7 below), ComEd discovered errors in the documentation supporting the changes to Rider ML. ComEd Exs. 12.8, 12.9.1, and 12.9.2. In response to Staff data request RDL 1.15, ComEd provided corrected supporting documentation. In its rebuttal testimony, ComEd provides a revised Rider ML (ComEd Ex. 32.5 and 32.9) that reflects the new data included in the data request response to RDL 1.15. Staff witness Linkenback reviewed the proposed changes to Rider ML and based on the corrected documentation he found the proposed changes to be reasonable. Staff Ex. 8.0 at 22.

The Commission finds the proposed adjustment to be just and reasonable.

4. Rate MSPS7 [and Rate BES-H] (Uncontested)

ComEd proposes to update the following groups of charges contained in Rate MSPS7: Metering Equipment Removal Charges; Meter Reading Charges; and MSP-Requested Work Charges. ComEd states that its proposed charges to Rate MSPS7 have not been challenged by Staff or Intervenors.

ComEd also proposes to update the proposed off-cycle termination fee in Rate BES-H and Rate BES-RR. ComEd stated that its proposed off-cycle termination fee in Rate BES-H and Rate BES-RR has not been challenged by Staff or Intervenors, and should be found to be just and reasonable. ComEd notes that Rate BES-RR has been superseded and replaced by Rate BES-H beginning in June, 2008, before this rate case concludes.

Staff does not oppose the changes proposed by ComEd to Rate MSPS7 – Metering Service Provider Service 2007.

During the course of providing answers to Staff data requests, ComEd discovered errors in the documentation supporting the changes to Rate MSPS7 and Rider ML (ComEd Exhibits 12.8, 12.9.1, 12.9.2 and 12.9.3). In response to Staff data request RDL 1.15, ComEd provides corrected supporting documentation. In its rebuttal testimony, ComEd provides revised Rate MSPS7 (ComEd Ex. 32.6 and 32.9) that reflect the new data included in the data request response to RDL 1.15. Staff witness Linkenback reviewed the proposed changes to Rate MSPS7 and based on the corrected documentation he found the proposed changes to be reasonable. Staff Ex. 8.0 at 25-26.

The Commission hereby approves the changes to Rate MSPS7and Rate BES-H.

E. Distribution Loss Factors

1. REACT

REACT objects to ComEd's proposed increase in the Distribution Loss Factor ("DLF") for its over-10 MW high voltage customers, arguing that it is clearly disproportionate to the proposed increase for other customer classes. DLF increases to the over-10 MW high voltage customers would increase by 36% versus the proposed increases to the "Large" (9%) and "Very Large" (15%) and "Extra Large" non-high voltage (15%) customer classes. *See* REACT Ex. 5.0 at 23-24. Within the over-10 MW customer classes there are very widely ranging DLFs. *See* Tr. at 541-42. REACT also notes that as with cost of service generally, ComEd opposes performing a particularized DLF analysis for over-10 MW customers.

In general, if a customer is responsible for a cost or involved in that cost, they should pay a portion of that cost. REACT believes that ComEd's refusal to perform particularized DLF analyses undercuts its purported desire to implement accurate cost causation systems in an effort to "move toward cost." *See* REACT Reply Br. at 38.

REACT argues that ComEd proposes enormous percentage increases in the DLFs for the over-10 MW high voltage customers, due to a change in ComEd's

proposed methodology for calculating DLFs, not because those customers have done something that would justify the increase. Because ComEd's proposed methodology does not calculate individual DLFs, the amount of the charge that ComEd proposes to the class definitely exceeds the particular distribution loss that many of the particular customers cause.

REACT says ComEd suggests that it is relevant that the Commission has in previous cases accepted ComEd's class-wide calculation of DLFs. However, REACT points out that the Commission is not bound by decisions in a prior case, and absent substantial evidence in this evidentiary record, the Commission is without authority to increase ComEd's DLFs. 220 ILCS 5/10-201(e)(iv)(A). According to REACT, on this evidentiary record, ComEd has not justified increasing its DLFs to its over-10 MW high voltage customers.

2. ComEd

ComEd explains that distribution system losses are an inevitable consequence of electricity flowing through the electric distribution system, or in some cases, by elements of the system being energized even if no power is flowing. ComEd Ex. 21.0 Corr. at 115. The name for quantification of these losses for ratemaking purposes is Distribution Loss Factors ("DLF"). ComEd explains that these power losses are in accordance with the laws of physics and not because of something wrong with the system. *Id.* In this case, ComEd presents what it refers to as a new and improved distribution loss study. ComEd contends that this study more accurately attributes the losses to customers using the electric distribution system. ComEd Ex. 21.0 Corr. at 115; ComEd Ex. 21.1. ComEd states that this study utilizes more sophisticated methodology, such as using data from a new geographical information system and including downstream losses in the load of certain upstream elements. ComEd Ex. 21.0 Corr. at 115-116. ComEd added that no contrary study has been offered by any party, nor has any evidence been presented to question the validity of the study.

In response to REACT's criticism that distribution losses have gone up even in areas where ComEd has made new upgrades and investments, ComEd states that while the new upgrades may be necessary to add capacity or improve reliability, they may also lead to additional losses. ComEd Ex. 21.0 Corr. at 117.

ComEd argues that REACT's suggestion that ComEd not be permitted to treat over-10 MW high voltage customers as a class for purposes of DLFs, and to instead calculate loss factors on a customer-by-customer basis is contrary to prior Commission ratemaking. DLFs have never been calculated and applied individually, but rather they have been allocated by customer class.

3. Staff

Staff found the changes to the existing DLFs in Rate RDS – Retail Delivery Service – to be reasonable. Staff Ex. 8.0 at 26.

Rate RDS provides the rates for ComEd to deliver power and energy to customers who have chosen to purchase all or a portion of their power and energy from suppliers other than ComEd. Staff witness Linkenback bases his determination that the

line loss factors were reasonable, on his review of the technical data provided by ComEd. He notes that ComEd uses the same procedure to calculate line losses as was approved in Docket 05-0597. The average system line loss increase from 6.12% in the Docket 05-0597 to 6.49% (revised by ComEd to 6.48%, ComEd Ex. 32.0 at 52:901) in the current case. The High Voltage delivery class customers line loss factors increased from 1.35% in 2005 to 1.99% for High Voltage customers over 10 MW and 3.30% for all other High Voltage customers (revised by ComEd to 1.83% and 2.28% respectively, ComEd Ex. 32.0 at 53 Table R12: Distribution Loss Factors).

In the current case, any concerns that Mr. Linkenback had were resolved after reviewing information provided by ComEd. In particular, ComEd indicated that: (1) a more accurate survey and accounting of load profiles, and substation and distribution transformers on ComEd's system was performed for the current study; (2) losses on the lower voltage system were better allocated to the supply or higher voltage delivery classes; and, (3) in the prior 2005 study, there was a understatement of the total high voltage transformer nameplate capacity which the current study corrected. Staff Ex. 8.0 at 26-27.

4. Commission Analysis and Conclusion

We find ComEd's DLF factors to be reasonable and supported by the record. We reject REACT's suggestions that they be modified or computed on a customer-by-customer basis. Determining individual DLFs would unnecessarily increase the complexity of rate hearings.

F. Recovery of Supply-Related Costs

This issue is addressed above.

G. Competitive Retail Market Development Issues

1. ComEd

ComEd states that REACT's claims that the Company is hindering development of a competitive retail market are incorrect and irrelevant to this case. Contrary to REACT's assertions about ComEd's motives, ComEd states that it strongly supports a competitive market for residential customers and has been working to advance efficient competition since the passage of the Electric Service Customer Choice and Rate Relief Law of 1997, 220 ILCS 5/16-101 *et seq*. Tr. at 1410. Moreover, ComEd states that REACT fails to recognize the historical factors that have dominated the degree to which residential customers could switch to RES service, such as the 20 percent rate reduction and a ten year rate freeze in effect until January 1, 2007. These factors were primary obstacles to the development of residential competition for supply. There are factors currently outside the control of ComEd that affect the degree of residential customer switching. *Id*. Moreover, residential customers usually have a relatively small load, generating a relatively small profit for a RES. This circumstance militates against an extensive competitive retail market.

2. REACT

REACT notes that ComEd summarily asserts that competitive retail market development issues have “nothing to do with the purpose of this proceeding, which is to set ComEd’s distribution rates.” ComEd Init. Br. at 120. REACT asserts that ComEd continues to maintain that cavalier attitude in its Reply Brief, stating that issues relating to the development of the competitive market “are irrelevant to this case.” ComEd Reply Br. at 146. REACT argues that this is a rather stunning position that disregards the history of this proceeding and the history of previous delivery services rate cases.

REACT contends that it introduced testimony on this issue which was admitted into the record without any objection from ComEd or any other party. Competitive market issues were explored repeatedly at the live hearings, beginning with the cross-examination of ComEd’s very first witness, ComEd CEO J. Barry Mitchell and during the cross-examinations of ComEd witnesses Ms. Clair, Mr. Crumrine, Mr. McDonald, and Mr. Alongi / Dr. Jones. Tr. at 259:13-16; Tr. at 1370:16-71:7; Tr. at 1799:7-1800:1; Tr. at 2230:13-20.

REACT finds ComEd’s responses to these issues to be remarkable because competitive retail market development issues are not new to ComEd’s delivery services rate cases. As REACT notes, since the very first ComEd delivery services rate, competitive retail market issues have been central to the proceeding. *See* Docket 99-0117, Order at 24 and 52 (Aug. 26, 1999); Docket 01-0423, Order at 24-25 (March 28, 2003); Docket 05-0597, Order at 272-94. REACT observes that competitive market issues must be considered in the context of the question of delivery service rates presented in the instant proceeding.

3. Commission Analysis and Conclusions

REACT’s assertion that ComEd has hindered development of a retail competitive market is not supported by this record. We find that the only relevance of retail market development issues to this proceeding is that the Commission has directed ComEd to determine that the appropriate measure of customer costs is assigned to bundled supply customers. ComEd is directed to include this calculation in its next rate filing as discussed in cost of service.

X. Revenues

A. Miscellaneous Revenues

We find that ComEd’s uncontested calculation of “Other Revenues” of $132,761,000 to be just and reasonable.

B. Weather Normalization

ComEd contends it correctly weather normalized its revenues under existing rates, and in calculating its proposed charges in ComEd Ex. 12.2 and in Schedule E 4 in its filing under Part 285 of the Commission’s rules, correctly weather normalized its billing determinants. AG/CUB presents testimony, but did not argue in their briefs, that ComEd’s figure for the revenue deficiency does not reflect weather normalization of revenues under existing rates.

Although AG/CUB argue that ComEd's figure for the revenue deficiency does not reflect weather normalization of revenues under existing rates, which decreases the revenue deficiency by $2,401,000, it is uncontested that that increase has no effect on the revenue requirement and that, because ComEd's proposed charges already reflect weather normalization of the billing determinants, it also has no effect on the proposed charges. Thus, any adjustment to the revenue requirement would be unnecessary and duplicative.

XI. Other

A. Annual Reporting on Changes in Accounting Policy

In response to Staff's recommendation and pursuant to the proposed set of issue resolutions set forth in the Stipulation, ComEd has agreed to provide to the Manager of the Commission's Accounting Department notice, not less than 21 days prior to the date on which the change is implemented, of ComEd's intent to change its (A) capitalization policy where such change is expected to result in an annual change in amounts capitalized of at least $10 million or (B) Property Unit Catalog where such change is expected to result in an annual change in amounts capitalized of at least $1 million. Staff-ComEd Joint Ex. 1 at 4. ComEd states that it has agreed to do this without conceding that, apart from its agreement, it is obligated to do so. ComEd Ex. 26.0 at 20-21; Staff-ComEd Joint Ex. 1 at 4.

The Commission finds Staff's recommendation to be just and reasonable. Accordingly, ComEd is required to notify the Manager of the Commission's Accounting Department in writing not less than 21 days prior to the date of changes in accounting policy that impact annual capitalization by more than $10,000,000. ComEd is also required to notify the Manager of the Commission's Accounting Department not less than 21 days prior to the implementation date for changes to the Property Unit Catalog that impact annual capitalization by more than $1,000,000.

B. Reporting on Affiliate Interest Transactions (Uncontested)

Staff recommends that ComEd report the amount it receives each year, by affiliate, from providing services to affiliated interests and for receiving services from affiliates, for each affiliate for which ComEd receives or pays over $500,000 annually, with a description of the services provided or received. This report should be filed as Supplemental Schedule to Form 21 ILCC, filed at the same time ComEd files the other Supplemental Schedules to Form 21 ILCC on or before May 1st. ComEd agrees with this recommendation and also agrees that this report will include what it refers to as "pass through" transactions.

The Commission finds Staff's recommendation to be just and reasonable.

C. Reporting on Pass-Through Transactions (Uncontested)

As part of its recommended reporting of services provided to affiliates, ComEd has agreed to report "pass-through transactions" for two types of situations: (1) "convenience payments" where one company pays an invoice on behalf of an affiliated company and then collects the amount paid from the affiliated company and (2) transactions where one company acts as a subcontractor to an affiliated company and

provides services to a third party, whose payment is passed through from the company it contracted with to the affiliated-company subcontractor. ComEd Ex. 26.0 at 23.

We find that the agreed reporting of pass through transactions is just and reasonable.

D. Future Depreciation Studies (Uncontested)

In response to Staff's recommendation, ComEd has agreed to schedule future depreciation studies every five years. ComEd Ex. 26.0 at 21-22. ComEd indicates its willingness to meet with Staff in the future to discuss the use of ComEd's internal auditors to conduct audits of additions to plant in service. Tr. at 1768-69.

The Commission finds that the agreement regarding future depreciation studies is just and reasonable.

E. Response to ALJ Post –Record Data Request

ComEd's response to the ALJ Post-Record Data Request failed to differentiate between the two high voltage classes in setting rates. IIEC performed these calculations and included them in its Reply to ComEd's Response to the Post Record Data Request ("Reply"). Subsequently, this issue was briefed by ComEd, DOE and IIEC. The Commission finds that the rates for the two high voltage classes calculated by IIEC in its reply are consistent with the rate increase contained in this Order. The Commission orders ComEd to charge the rates stated therein to the high voltage classes.

XII. Findings and Ordering Paragraphs

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) Commonwealth Edison Company is an Illinois corporation engaged in the transmission, distribution, and sale of electricity to the public in Illinois and is a public utility as defined in Section 3-105 of the Public Utilities Act;

(2) the Commission has jurisdiction over the parties and the subject matter herein;

(3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact and conclusions of law; the Appendix attached hereto provides supporting calculations;

(4) the test year for the determination of the rates herein found to be just and reasonable should be the 12 months ending December 31, 2006; such test year is appropriate for purposes of this proceeding;

(5) for the test year ending December 31, 2006 and for purposes of this proceeding, the Company's rate base is $6,694,039,000;

(6) a just and reasonable return which ComEd should be allowed to earn on its net original cost rate base is 8.36%; this rate of return incorporates a return on common equity of 10.3% and on long-term debt of 6.74%;

(7) the rate of return set forth in Finding (6) results in base rate operating revenues of $1,961,065,000 and net annual operating income of $559,623,000 based on the test year approved herein;

(8) ComEd's rates which are presently in effect are insufficient to generate the operating income necessary to permit ComEd the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;

(9) the specific rates proposed by ComEd in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; ComEd's proposed rates should be permanently canceled and annulled consistent with the findings herein;

(10) ComEd should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of $1,961,065,000 which represent an increase of $273,573,000; such revenues will provide ComEd with an opportunity to earn the rate of return set forth in Finding (6) above; based on the record in this proceeding, this return is just and reasonable;

(11) the determinations regarding cost of service, rate design, and terms and conditions of service contained in the prefatory portion of this Order are reasonable for purposes of this proceeding; the tariffs filed by ComEd should incorporate the rates, rate design, and terms and conditions set forth and referred to herein;

(12) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than four calendar days after the date of filing, with the exception that tariff sheets for Rider SMP shall reflect an effective date not less than 15 business days after the date of filing, with the tariff sheets to be reviewed by the Staff of the Commission and corrected, if necessary, within that time period;

(13) the Commission authorizes rates based on the ECOSS, with a 25% movement toward ECOSS based rates for the Extra Large Load, High Voltage, and Railroad delivery classes;

(14) the Company should provide audits, reports and studies, as directed herein in regard to supply only customer costs, load flow for railroad class customers, changes in accounting policy, affiliate interest transactions, pass through transactions and future depreciation;

(15) Rider SMP is approved for the limited purpose of implementing the Phase 0 of AMI deployment, as approved herein;

(16) Staff, ComEd and interested parties are directed to initiate the AMI Workshop and Statewide Smart Grid Collaboratives for purposes of considering AMI and Smart Grid, as described herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect rendered by Commonwealth Edison Company are hereby permanently canceled and annulled, effective at such time as the new tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general rate increase, filed by Commonwealth Edison Company on October 17, 2007, are permanently canceled and annulled.

IT IS FURTHER ORDERED that Commonwealth Edison Company is authorized to file new tariff sheets with supporting workpapers in accordance with Findings (10), (11), and (12) of this Order, applicable to service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that Commonwealth Edison Company shall base its rates on the embedded cost of service study, with a 25% movement toward the embedded-cost-of-service-study based rates for the Extra Large Load, High Voltage, and Railroad delivery classes.

IT IS FURTHER ORDERED that Commonwealth Edison Company is directed to provide reports and studies, as directed herein, on bundled supply customer costs, street lighting costs, separation of costs for primary and secondary service, the nature and extent of use of railroad class customers facilities to provide service to other customers, changes in accounting policy, affiliate interest transactions, pass through transactions and future depreciation.

IT IS FURTHER ORDERED that Rider SMP is approved as described herein for the limited purpose of implementing the Phase 0 of AMI deployment, as approved herein.

IT IS FURTHER ORDERED that Staff, ComEd and interested parties are directed to initiate the AMI Workshop and Statewide Smart Grid Collaboratives for purposes of considering AMI and Smart Grid, as described herein.

IT IS FURTHER ORDERED that Commonwealth Edison Company is directed to charge rates for the two high voltage classes consistent with those calculated by IIEC in its Corrected Reply to ComEd's Response to the Post Record Data Request.

IT IS FURTHER ORDERED that any motions, petitions, objections, and other matters in this proceeding which remain outstanding are hereby denied.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 10th day of September, 2008.

(SIGNED) CHARLES E. BOX

CHAIRMAN