STATE OF ILLINOIS

BEFORE THE ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	**)**	
	)	
Petition for Approval of Tariffs	**)**	**Docket No. 06-0411**
Implementing ComEd's Proposed	**)**	
Residential Rate Stabilization Program	**)**	

DIRECT TESTIMONY OF
JONATHAN WALLACH
ON BEHALF OF
THE CITIZENS UTILITY BOARD, THE COOK COUNTY STATE'S ATTORNEY'S OFFICE, AND THE CITY OF CHICAGO

CUB-CCSAO-CITY EX. 1.0

JULY 11, 2006

Q: Please state your name, occupation, and business address.

A: I am Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5 Water Street, Arlington, Massachusetts.

Q: Please summarize your professional education and experience.

A: I have worked as a consultant to the electric-power industry for more than two decades. From 1981 to 1986, I was a research associate at Energy Systems Research Group. In 1987 and 1988, I was an independent consultant. From 1989 to 1990, I was a senior analyst at Komanoff Energy Associates. I have been in my current position at Resource Insight since September of 1990.

Over the last twenty-five years, I have advised clients on a wide range of economic, planning, and policy issues including: electric-utility restructuring; wholesale-power market design and operations; transmission pricing and policy; market valuation of generating assets and purchase contracts; power-procurement strategies; integrated resource planning; cost allocation and rate design; and energy-efficiency program design and planning.

My resume is attached as CUB-CCSAO-City Exhibit 1.01.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Citizens Utility Board, the Cook County State's Attorney's Office, and the City of Chicago.

Q: What is the purpose of your testimony?

A: On May 23, 2006, Commonwealth Edison Company ("ComEd"or the "Company") filed a petition and testimony in support of a proposal to establish a Residential Rate Stabilization Program. This testimony addresses the Company's petition and supporting testimony.

In addition, on June 15, 2006, the Ameren Companies filed a petition in Docket No. 06-0448 in support of a proposal to defer and securitize power costs. This testimony discusses the implications of the Ameren petition for this docket.

Q: Please summarize the Company's proposal for a Residential Rate Stabilization Program.

A: In anticipation of significant rate increases due to the switch from frozen to market-based rates, the Company proposes a program to mitigate the impact on consumers by spreading the rate increase over a three-year period. Specifically, ComEd proposes to cap 2007 rates at 108% of 2006 levels, 2008 rates at 107% of 2007 levels, and 2009 rates at 106% of 2008 levels. The Company further proposes to defer all costs that exceed these caps as a regulatory asset and accrue interest on all such deferrals at its authorized rate of return. The deferred balance at the end of this three-year transition period would be recovered over the following three years.

Under the Company's proposal, costs would be deferred (recovered) via a separate non-bypassable line-item credit (surcharge); customers would continue to see actual, market-based supply prices on their bills.

Q: Should the Commission approve ComEd's Proposal?

A: No. I have been advised by Counsel that the Commission may lack legal authority to approve the Company's proposal. In fact, the Ameren petition states that the Commission may lack authority to approve a similar petition. Ameren Petition, Docket No. 06-0448, p. 4.

However, even if the Commission rules otherwise on the question of legal authority, it should not approve the Company's proposal. As discussed below, the Company has not provided the Commission with sufficient information to evaluate the proposal. Moreover, the Company's proposal imposes excessive costs on consumers and is thus contrary to the public interest.

One method for reducing costs to consumers is to securitize any deferral amounts, as recommended in the Ameren Petition. The recommendation by the Ameren Companies to pursue securitization is appropriate and reasonable when applied to ComEd's proposal, and should be adopted by the Commission in this docket in order to minimize costs to consumers.

Q: Does the Company adequately explain the basis for the annual percentage increases proposed by the Company for the three-year transition period?

A: No. Neither the petition nor the supporting testimony provide an explicit rationale for the proposed annual percentage increases to total rates.

In this regard, I note that the three incremental rates increases amount to a cumulative rate increase of approximately 22%. Based on rate increases experienced in other jurisdictions moving to market-based rates, this 22% increase would likely represent only a fraction of the total increase associated with the switch to market-based rates.[1] As a result, there is a significant risk that consumers will be faced with additional rate increases to bring rates up to full market levels at the end of the transition period and at the same time

[1] For example, Baltimore Gas & Electric experienced a 72% increase in total rates as a result of the switch from frozen to market-based rates for power supply. In addition, the Ameren Petition (paragraph 6) states that the Ameren Companies estimate that rates will increase 20%-35% at the end of the rate freeze.

that they must pay an additional surcharge associated with the recovery of the deferred balance. Unfortunately, the Company has not provided either the expected magnitude of this final increase to bring rates in line with market or the additional rate impact associated with rate recovery of deferred costs.[2]

Q: Has the Company provided an estimate of the expected total amount of deferrals or the interest accrued on such deferrals?

A: The Company has not provided its estimate of the likely magnitude of cost deferrals or the interest accruals on those deferred amounts. Consequently, the Commission and other parties lack essential information for judging either the financial impact to the Company or the cost impact to ratepayers of the Company's proposal.

The failure to provide such essential information is particularly troubling given the Company's stated concerns regarding the potential financial stress from the proposed deferrals. According to Company witness J. Barry Mitchell:

> The RRS program would have a significant financial impact on ComEd. Deferring the recovery of procurement costs will hurt both ComEd's cash flow and liquidity, limit its ability to respond to unexpected events and demands for investments, and may negatively impact its credit ratings. These effects will be magnified in the event that costs turned out to be significantly in excess of the percentage "caps" applicable under the program for the years 2007 through 2009.[3]

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[2] The Company provided an illustrative example of the impact of its proposal in ComEd Exhibit 2.3. However, this example assumed that total rates increase by only 15% at the end of the rate freeze. Thus, this example assumes no further rate increase at the end of the transition period to bring rates up to full market-based levels.

[3] *Direct Testimony of J. Barry Mitchell*, Docket No. 06-0411, May 23, 2006, pp. 8-9.

Mr. Mitchell further states that:

> The RRS program, as proposed, already stretches the limits and imposes significant financial risks on ComEd. Proposals that … deferrals be increased … magnify those risks greatly and result and result in financial burdens that would be unacceptable to ComEd and not in the best interest of its customers.[4]

Given the likelihood that the increase from frozen to market-based rates will be "significantly in excess of the percentage 'caps'," and hence that deferrals will be greater than rate increases at capped levels, the prudent course of action would have been for the Company to estimate the cost and financial impacts using their best current estimate of the likely rate increase resulting from the switch from frozen to market-based rates.

Q: What is the basis for the Company's proposal to provide a return on deferred amounts at its authorized rate of return?

A: According to Mr. Mitchell:

> … [B]ecause ComEd would have to finance any deferred costs, it must be allowed to recover its cost of capital related to the expenses that are deferred. Under the RRS program, ComEd's cost of capital is the pre-tax annual rate of return on its rate base most recently allowed by the Commission.[5]

Q: Should the return on deferred costs under the Company's proposal be the same as for other ratebase assets?

A: Not necessarily, and ComEd's testimony fails to support such a finding. Deferred costs under the Residential Rate Stabilization Program are significantly less risky than other regulated investments, since:

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[4] *Id.*, p. 11.

[5] *Id.*, p. 7.

- Deferred costs will be recovered over a much shorter period than is typical for amortization of utility-plant investment.
- Unlike costs associated with other ratebase assets, the Company proposes a true-up to ensure recovery of the full deferred amount (with return.)
- Unlike other regulatory assets, the Company's proposal provides for early termination and accelerated recovery of deferral balances if the Company experiences financial distress.

These attributes minimize the risk associated with recovery of deferred costs, and thus reduce the return required to appropriately compensate for that risk.

Q: How should the rate of return on the deferral asset be determined?

A: The rate of return should be based on the cost of funds secured to cover the deferral balance. Setting the return in excess of actual finance costs would inappropriately provide a windfall to shareholders and unjustly harm consumers.

As discussed in the Ameren petition, short-term debt would be a likely source of funds for financing the deferral asset. Alternatively, the Ameren petition proposes securitization of the asset to further reduce the cost of financing. To this end, the Ameren petition recommends that the Commission investigate the use of securitized financing as part of a deferral plan and to withhold final approval of any such deferral plan until such time as legislation enabling securitization is adopted.

Q: If the Commission finds that the Company can accrue interest as it has proposed, are there steps it should take to give customers a choice regarding the payment of this additional cost?

A: Yes. If the Company is allowed to accrue interest at its authorized rate of return, it should also be required to implement the Residential Rate Stabilization Program on an opt-in basis. Under these circumstances, consumers should be provided the opportunity to decide whether it is in their best interests to finance their power-supply costs at the Company's weighted average cost of capital. In other words, customers should be given the opportunity to pay the market cost of power rather than being forced to pay carrying charges at rates that may exceed ordinary loan rates.

Q: Will new residential accounts established after January 2, 2007 be subject to the same deferral credits and surcharges as existing accounts under the Company's proposal?

A. The Company has not specified how new customers will be treated during either the transition period (2007-2009) or repayment years (2010-2012). It would not be reasonable to impose the same deferral surcharges on a new account as on an account existing prior to the start of the deferral plan, since the total deferral credit received through the transition period will be less for the new account than for the existing account. This problem is exacerbated for customers moving into the ComEd service territory during the repayment years. Under the Company's proposal, these customers will have to pay deferred surcharges for a deferral plan from which they did not benefit.

Q: Has the Company placed any conditions on its proposal to implement the Residential Rate Stabilization Program?

A: Apparently so. According to Mr. Mitchell:

> The residential rate stabilization program is premised on the assumption that Docket 05-0597 will result in an order permitting ComEd to recover its reasonable and prudent costs and to earn a fair rate of return of and on its rate base. If ComEd were prohibited from recovering its costs and were denied the opportunity to earn a fair rate of return, its financial condition would be affected adversely and, as a result, its ability to support the program would be compromised.[6]

Q: Is this a reasonable condition?

A: No. The Company should not be allowed to hold the Residential Rate Stabilization Program hostage to the Commission's decision in Docket 05-0597. Either the proposal is in the public interest or it is not. It's not acceptable policy to make a finding on the public interest in one case contingent on the Commission's order in another case.

Q: What are your recommendations with regard to the Company's proposed Residential Rate Stabilization Program?

A: The Commission should not approve the Company's proposal. Instead, as recommended in the Ameren Petition for the Ameren companies, the Commission should conduct an investigation, either as part of the instant docket or in a separate docket, of the mechanics and impact of securitized financing of power-cost deferrals.

To facilitate that investigation, the Company should be directed to provide the Commission and other parties estimates of the likely rate impacts of the switch from frozen to market-based rates, along with its estimate of the magnitude of cost deferrals and interest accruals (under a range of financing

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[6] *Id.*, pp. 10-11.

assumptions) associated with the Residential Rate Stabilization Program. As discussed above, the Company failed to provide such essential information as part of its petition. Consequently, the Commission has not been provided with the information necessary for determining whether the Company's proposal is in the public interest.

Q: Does this conclude your testimony?

A: Yes, at this time.