

# Illinois PIRG

## Formula rates are dead, long live guaranteed profits

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### Introduction

In the wake of the Commonwealth Edison corruption scandal, seemingly everyone has professed a commitment to end formula rates, a key policy won during the bribery scheme. As details of a compromise energy bill emerged in the final days of the legislative session, legislators and other parties to the negotiations have said that the energy bill ends formula rates. For example, the Crain's Chicago Business June 1 story, [Here's what's in the big state energy bill still awaiting action](#), states the “controversial formula-rate authority that ComEd and Ameren Illinois enjoy, thanks to a law passed in 2011, would end.”<sup>1</sup>

According to drafts of the legislation circulated in late May and early June,<sup>2</sup> this is inaccurate on two levels.

First, rather than end the current formula rate policy ahead of its current December 31, 2022 sunset, the legislation not only leaves that timeline in place, it extends a portion of the current formula rate, annual actual cost reconciliations, past 2022. Second, **the legislation incorporates key formula rate policies into a new ratemaking structure, extending utilities' guaranteed profits.**

These annual actual cost reconciliations, a process explained in more detail below, must end if the General Assembly wishes to completely end formula ratemaking. Instead, the omnibus legislation codifies the contention, initially made by ComEd in support of their 2011 law, that Illinois' large electric utilities cannot invest in their infrastructure unless they have “certainty,” that is, a guarantee to profit on every dollar they spend.

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<sup>1</sup> Steve Daniels, Here's what's in the big state energy bill still awaiting action, Crain's Chicago Business, June 1, 2021.

<sup>2</sup> As of publishing, legislation has not been publicly released. Our analysis is based on a draft circulated by the Governor's office Thursday, June 10th.

On top of continuing the “certainty” that guarantees ComEd and Ameren profits, the omnibus legislation **significantly increases the amount of those company profits**, by effectively raising their profit margin, known as the Return on Equity, or ROE.

One unintentional silver lining of formula ratemaking has been relatively low ROEs, as the rate-setting formula tied the ROE to interest rates, which have been historically low. This is one critical piece of formula ratemaking *not* carried over into the new ratemaking structure. Instead, the ROE will once again be set by the Commission, which would reward ComEd and Ameren higher ROE’s than they currently have under formula rates.

**The combination of extending formula rate profit guarantees with higher utility profit margins represents a windfall for ComEd and Ameren. Its value for ComEd is almost certainly more than the subsidy the legislation provides Exelon.**

To demonstrate the potential value of this windfall to ComEd, we have calculated ComEd’s profits over the next four years as if the company had the higher ROE from the bill over that time. *To be clear, this is not a prediction, as new rates from the new ratemaking scheme will not kick in until 2024.* Rather, our calculations provide an indication of the significant windfall this legislation provides ComEd.

## Findings

To provide an indicative view of what ComEd’s profits could be after the impacts of the omnibus legislation, we created an “Omnibus Scenario.” Our calculations are based off of ComEd’s projected rate base, the value of its assets it earns a profit off of, as reported to Exelon investors in February 2021.<sup>3</sup> We used the most recent Commission-granted ROE, to Ameren Gas in ICC Docket No. 20-0308<sup>4</sup> (the second most recent ROE, to Nicor Gas, is higher<sup>5</sup>). We inserted this ROE into the capital structure used to calculate ComEd’s 2021 rates<sup>6</sup> to determine an overall Weighted Average Cost of Capital (WACC) also known as the overall Rate of Return (ROR), which is applied to a utility’s rate base to determine its overall profits.

### **Under this Omnibus Scenario, we found:**

- ComEd would begin collecting over \$1 billion in authorized profit from customers in 2023.<sup>7</sup>
- Over four years, 2021 through 2024, ComEd would be authorized to earn \$3.9 billion in profit, not accounting for additional profits from regulatory assets. For reference, in the

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<sup>3</sup> Exelon Earnings Conference Call Fourth Quarter 2020, February 24, 2021, Slide 36. Available at: <https://investors.exeloncorp.com/static-files/2dda3a5d-b5c9-40d6-829f-da5c2efd6cc9>

<sup>4</sup> ICC Docket 20-0308, Final Order, page 169.

<sup>5</sup> ICC Docket 18-1775, Final Order, page 124-5.

<sup>6</sup> ICC Docket 20-0393, Final Order, page 71.

<sup>7</sup> Under the actual timeline in the bill this would be the impact on customer bills just one year later, or 2024.

12 years ComEd existed as an Exelon subsidiary before formula rates began, it reported \$3.9 billion in profit to the Securities and Exchange Commission.

- We also compared ComEd's profits under the Omnibus Scenario to two baselines.
  - In Baseline One, we applied the overall Rate of Return, as proposed in ComEd's current formula rate update docket, to the same ComEd rate base projections shared with Exelon investors. **Compared to Baseline One, under the Omnibus Scenario, ComEd would make an additional \$664 million in profits over four years.**
  - In Baseline Two, the rates ComEd customers are paying in 2021 would be frozen in place over the four year period--as if formula rates, including the annual formula rate update before the Commission now, ICC Docket No. 21-0367, were stopped. **Compared to Baseline Two, under the Omnibus Scenario, ComEd would make an additional \$893 million in profits over four years.**

This means that were ComEd to enjoy a higher ROE over the next four years, it would earn somewhere between \$166 million to \$223 million in additional profits per year. Exelon's subsidy from the legislation, reported to be \$694 million over five years,<sup>8</sup> amounts to "only" \$139 million per year.

Again, under the omnibus legislation, ComEd would not actually collect rates based on a higher ROE until 2024, so this scenario is not predictive, but rather indicative of the future profits ComEd could earn based on the best information currently available.

Reasonable people may disagree as to the merits of other elements of the legislation's proposed "Performance-Based Ratemaking," but the authors know of no good faith public interest rationale for guaranteeing utility profits as formula rates do and this legislation would continue.

**If the Illinois General Assembly intends to completely end formula ratemaking, it must amend the omnibus legislation to, at a minimum, eliminate annual actual cost reconciliations and the "Tariff regarding transition in rates."**

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<sup>8</sup> Dave McKinney & Tony Arnold, New Energy Bill Pushed By Gov. JB Pritzker Would Save Nuclear Plants — But Cost Customers Nearly \$700 Million, WBEZ, June 10, 2021.

## The most important policy in formula rates: “actual costs” guarantee profits

Annual actual costs reconciliations, more than the “formula” in formula rates, guarantee utility profits.

As described in our December 2020 report, [\*Guaranteed Profits, Broken Promises\*](#), under traditional utility regulation, when setting a utility’s rates, the Commission seeks to set a level of annual revenue that allows for the *opportunity*, but not the *guarantee*, to recover the utilities investment and expense costs, as well as a profit for shareholders, through the rates customers pay.

That revenues and profits are not guaranteed under traditional regulation is intentional and important. It encourages efficient spending and management; it means shareholders bear some of the operational risks inherent to the utility enterprise.

As ComEd repeatedly made clear when advocating for formula rates, turning this opportunity into a guarantee, creating “certainty,” was the primary goal of formula rates. The company said it could not make grid modernization and reliability investments “without the stability and predictability embodied in the regulatory reform section of the bill.”<sup>9</sup>

This certainty, more than the actual formula equation, which is a 30-page document used to determine year-to-year rates,<sup>10</sup> is the key policy within formula rates. This certainty guarantees utility revenue and profit; the companies know that every dollar of capital investment will be recovered with profit and all operating expenses will be recovered in full.

To simplify, the two words that provide this certainty are not “formula rate,” but “actual costs.” Actual costs are the subject of an annual formula “true-up” or “reconciliation” to compare the projected costs for the year, off of which rates were based, with what the utility actually spent, its actual costs for that year. If costs were higher or lower than projected, the difference, along with interest, will be charged or credited to customers in future rates.

This guarantee has resulted in increased customer bills

Under traditional regulation, if a utility spends more than planned in a given year, all else being equal, it will profit less. If it is more efficient, all else being equal, it will profit more. With an annual actual cost reconciliation, if ComEd spends more than planned, all else being equal, ComEd’s revenue will automatically go up, as will our bills.<sup>11</sup> ComEd has used this dynamic to

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<sup>9</sup> ComEd Press Release, “ComEd, Illinois Business Owners Testify About Economic Benefits of Grid Modernization,” April 6, 2011

<sup>10</sup> For example see 20-0393 December 16, 2020 Compliance Filing, Exhibit B

<sup>11</sup> ComEd defends this process by saying that the Commission checks each and every investment. *Guaranteed Profits, Broken Promises* has more on this talking point however we can point out two things quickly. First, under formula rates, the Commission has not disagreed with a single cent of ComEd’s investment spending -- while ComEd doubled it. Second, there is a meaningful difference between the

increase customer bills more than needed for the investments specified by the Energy Infrastructure Modernization Act (EIMA), resulting in customers paying 37 percent more for distribution service.

ComEd has used formula rates' actual costs guarantee for far more than the EIMA specified investments. EIMA specified \$2.6 billion in ComEd reliability and smart grid investments over ten years — these were the investments that ComEd argued made formula rates “necessary.” But ComEd has spent an additional \$2.6 billion above and beyond EIMA investments (and above its baseline capital spending) since 2016.<sup>12</sup> Rather than just facilitating the EIMA specified investments, formula rates' actual costs guarantee is a profit machine for Exelon.

ComEd used formula rates and its actual costs guarantee to create a “new normal.” Before formula rates, ComEd spent around \$900 million in capital spending annually, with no guarantee to profit of every dollar spent. ComEd now spends around \$1.5 billion a year, while profiting off of every dollar.<sup>13</sup>

Even if one accepts the contention that formula rates were at one point necessary to make the EIMA specified investments, which the authors do not, the remaining amounts of specified investments are so small such that ending formula rates would pose no problem for ComEd or Ameren. ComEd has only \$7 million left to spend, out of \$2.549 billion specified, or 0.27 percent.<sup>14</sup> Ameren has only \$15 million left out of \$715 million specified, or 2 percent.<sup>15</sup>

Guaranteeing utility profits through annual actual costs reconciliations is unnecessary and harmful to customers.

## The omnibus energy legislation maintains the actual costs guarantee

Under the proposed omnibus energy legislation, new Section 16-108.18, “Performance-Based Ratemaking,” extends key formula rate policies, namely, an annual actual cost reconciliation, as well as two of three related [accounting practices codified by a 2013 law](#) ComEd advocated for after not getting its desired outcomes from the Commission.

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Commission approving a level of costs for a typical year vs. ensuring each and every dollar of investment spending, year after year, is prudent.

<sup>12</sup> Compare yearly totals for 2016 through 2020 in Commonwealth Edison Company's Infrastructure Investment Plan, 2021 Annual Update, April 1, 2021, page 64, combined plus the relevant annual amounts of the \$9.2 billion baseline in Commonwealth Edison Company's Infrastructure Investment Plan, 2021 Annual Update, April 1, 2021, page 10, with the annual capital additions in 20-0393 AG Initial Brief page 17 and 21-0367 ComEd Exhibit 4.02.

<sup>13</sup> Commonwealth Edison Company's Infrastructure Investment Plan, 2021 Annual Update, April 1, 2021, page 10; 20-0393 AG Initial Brief page 17; and 21-0367 ComEd Exhibit 4.02.

<sup>14</sup> Commonwealth Edison Company's Infrastructure Investment Plan, 2021 Annual Update, April 1, 2021, 64.

<sup>15</sup> Ameren Illinois, Modernization Action Plan, Infrastructure Investment Plan, April 1, 2021, Appendix B, Figure B.2.

The section does not extend the specific formula rate tariff created by EIMA, does not include a specific formula equation to determine all distribution rates generally or the ROE specifically, and avoids the label “annual reconciliation,”<sup>16</sup> but nonetheless includes an annual actual cost reconciliation, the policy that guarantees utility profits.

The annual actual cost reconciliation is termed an “Annual Adjustment” and found in Section 16-108.18(f)(6) of the omnibus energy legislation, an unnamed subsection of the Annual Performance Adjustment.

“The Commission shall determine the prudence and reasonableness of the **actual costs** incurred by the utility during the applicable calendar year, as well as determine the original cost of plant in service as of the end of the applicable calendar year. The Commission shall then determine the Annual Adjustment, which shall mean the amount by which, the electric utility’s actual revenue requirement for the applicable calendar year of the Multi-Year Rate Plan either exceeded, or was exceeded by, the revenue requirement approved by the Commission for such calendar year, plus carrying costs calculated at the weighted average cost of capital<sup>17</sup> approved for the Multi-Year Rate Plan. [...] The Commission’s determination ... shall be based on ... (B) the year-end rate base...”<sup>18</sup> (emphasis added)

For reference, the same basic process is described in the current formula rate law:

“The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the **actual costs** for the prior rate year. Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.”<sup>19</sup> (emphasis added)

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<sup>16</sup> In this regard it is more like the Climate Union Jobs Act which also tried to avoid giving a “reconciliation” label to a reconciliation as discussed above. 16-108.18 also changes the name of interest at the company’s weighted average cost of capital into “carrying costs calculated at the weighted average cost of capital”. See section 16-108.18(f)(6) page 760.

<sup>17</sup> Interest, or a carrying cost, at the weighted average cost of capital is one of the favorable accounting treatments gained by ComEd in 2013 which has increased company profits by roughly \$90 million since then. See <https://illinoispirg.org/blogs/blog/ilp/comed%E2%80%99s-650-million-power-play>

<sup>18</sup> Using year-end rate base is another one of the favorable accounting treatments that ComEd won in 2013. Year-end rate base has increased ComEd’s profits by roughly \$226 million since then. See <https://illinoispirg.org/blogs/blog/ilp/comed%E2%80%99s-650-million-power-play>

<sup>19</sup> ILCS Sec. 16-108.5 (d)(1)

The language is different because, under current law, the process takes place within the actual formula of formula rates,<sup>20</sup> but the overall process is the same: at the conclusion of each year, expected costs used to set rates for that year are compared to that year's actual costs, with the guarantee of recovering any additional expenses, with interest.

While the omnibus legislation includes additional language and provisions intended to appear as consumer protections, as discussed below, they do little to change the fundamental fact that this process held over from formula rates continues to guarantee utility profits.

This legislation does not end the current formula rate law, but extends it

Governor Pritzker's Climate and Consumers First Act proposed both sunseting the current formula rate one year ahead of schedule and eliminating vague language in the formula rate law that would allow for at least one additional actual cost reconciliation after the sunset date.<sup>21</sup> The omnibus bill, in contrast, allows the current formula rate law to continue and allows for multiple additional actual cost reconciliations.

Rather than providing an earlier sunset to the current formula rate law, the omnibus energy bill allows the current law, 16-108.5, to continue through its December 31, 2022 sunset date. ComEd and Ameren are both currently engaged in annual formula rate update dockets,<sup>22</sup> both of which all but guarantee an increase in distribution rates for ComEd and Ameren customers. The omnibus legislation does not make any modifications to section 16-108.5, thus allowing the current, ongoing rate increases to go through and allowing for another formula rate update next year. This is despite the fact that, should their investments proceed as planned this year, neither utility will make any EIMA specified investments in 2022.<sup>23</sup>

Further, the omnibus legislation ensures that ComEd and Ameren will be able to perform annual actual cost reconciliations over the years between the end of the current formula rate law and the start of the new rate structure outlined in the legislation. In so doing, the omnibus legislation ensures that ComEd and Ameren will not lose their profit guarantee for a single day over the transition between the current and new ratemaking process.

Section 16-108.25 of the omnibus legislation extends formula rates by incorporating a recent Commission decision in ICC Docket No. 20-0426. In its Final Order, the Commission granted Ameren the ability to perform annual actual cost reconciliations multiple years into the future.

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<sup>20</sup> The omnibus legislation only requires their new ratemaking to be implemented through tariffs filed at the Commission. These tariffs could contain formulas similar to formula rates. The bill, however, does not require a formula and annually updated inputs as EIMA did.

<sup>21</sup> Climate and Consumers First Act, HB4074/SB2896, page 651 deleting "subject to retroactive adjustment, with interest, to reconcile rates charged with actual costs." This is one example of similar language which was deleted in multiple places in the bill.

<sup>22</sup> ComEd: ICC Docket No. 21-0367; Ameren: ICC Docket No. 21-0365.

<sup>23</sup> Ameren Illinois, Modernization Action Plan, Infrastructure Investment Plan, April 1, 2021, Appendix B, Figure B.2; and Commonwealth Edison Company's Infrastructure Investment Plan, 2021 Annual Update, April 1, 2021, page 64

The Commission interpreted vague language from the 2011 formula rate law as rebutting “any arguments that formula rates do not extend beyond December 31, 2022 in some form.”<sup>24</sup>

Therefore, so long as ComEd and Ameren elect to participate in the new multi-year rate plan process, which itself includes an annual actual cost reconciliation, they would then not experience a single day without their profits guaranteed by the reconciliation process.<sup>25</sup>

## The omnibus legislation greatly increases the utilities guaranteed profits

The omnibus legislation not only continues to guarantee utility profits, it also greatly increases those profits by returning Commission discretion to determining the utilities’ Return on Equity (ROE), or profit margin.<sup>26</sup> The ROE under formula rates has been unexpectedly low because the formula ties the ROE to interest rates, which have been historically low. Returning to Commission discretion effectively ensures a higher ROE.

The omnibus legislation directs the Commission to set the ROE levels “consistent with Commission practice and law.”<sup>27</sup> ComEd’s proposed ROE in its 2021 formula rate update, ICC Docket No. 21-0367, is 7.36 percent. ComEd’s last ROE that was not set by the formula, set in ICC Docket No. 10-0467, was 10.5 percent.

A strong case could be made that the Commission should maintain ComEd’s low ROE because annual actual cost reconciliations mean investor dollars are at less risk. However, the two most recent ROEs that the Commission has set were 9.67 percent for Ameren Gas in Docket No. 20-0308 and 9.73 percent for Nicor Gas in Docket No. 18-1775. Both utilities enjoy a similar type of automatic recovery of actual costs through Rider QIP but the Commission does not seem to have in any way considered that effect on their cost recovery when determining their ROE’s.<sup>28</sup>

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<sup>24</sup> Final Order, ICC Docket No. 20-0426, 13. One can see the actual formula that is extended for Ameren on page four of the Appendix to the Final Order in ICC docket 20-0426. Under the omnibus legislation Ameren would be able to refile this tariff and it would automatically go into effect 45 days later. <https://icc.illinois.gov/docket/P2020-0426/documents/308760/files/538210.pdf>

<sup>25</sup> The tariff mechanism that the Commission had to approve in Docket 20-0426 allows Ameren to enjoy up to two years of reconciliations (Ameren had initially asked for more), which if formula rates end next year would cover 2022 and 2023, through reconciliations happening in 2023 and 2024. Section 16-108.18(d)(9)(B) page 736 holds that both ComEd and Ameren have to come in for either a general rate case or multi-year rate case by January 20, 2023. Subsection (d)(1) (page 730) holds that the rates go into effect January 1 2024. Section 16-108.18(f)(6) holds that those rates starting at the beginning of 2024 would then be subject to what is in everything but title a reconciliation at actual costs. Thus, section 16-108.5 handles the reconciliation of 2021 rates, the new Section 16-108.25 handles years 2022 and 2023 and the new Section 16-108.18 picks up from there.

<sup>26</sup> For a more detailed introduction to Return on Equity, Rate of Return, and Rate Base see Abraham Scarr and Jeff Orcutt, Guaranteed Profits, Broken Promises, December 2020, 26 - 28.

<sup>27</sup> Draft omnibus legislation, 16-108.18(d)(3)(B) page 732

<sup>28</sup> ICC Docket 18-1775 pages 116 - 121; ICC Docket 20-0308 pages 130 - 169

In ComEd's current, ongoing formula docket, ComEd's proposed 7.36 percent ROE is included with other considerations, such as the cost of long-term debt, to determine an overall Rate of Return (ROR), which is the company's return percentage applied to investments. With ComEd's capital structure, a 7.36 percent ROE represents an ROR of 5.72 percent. Even with the decreased costs to long-term debt, if the Commission were to grant ComEd a ROE consistent with what it recently granted the gas utilities, it would represent an ROR increase of more than 100 basis points.

## Our analysis

To demonstrate the value of the combination of continuing the profit guarantee along with a higher profit level, we have calculated ComEd's profits over the next four years as if the company had a higher ROE starting now. To repeat, this is not a prediction, as new rates from the new ratemaking scheme will not kick in until 2024. Rather, our analysis is an attempt to quantify an indicative impact of the omnibus legislation on ComEd's profits, paid for by customer rates, based on currently available data.

For the purposes of this analysis, we created an "Omnibus Scenario" in which the capital structure contained in ComEd's 2020 formula rate update stays consistent over four years, 2021-2024. This is the capital structure that was used to determine the rates we are currently paying in 2021.

We combined the latest ROE approved by the ICC for a major utility, Ameren's 9.67 percent, with ComEd's 2020 capital structure to get an overall ROR of 6.89 percent.

We used the rate base additions according to the schedule that Exelon told investors it anticipates over those four years.<sup>29</sup> The remaining value of the rate base assets is what the profit margin, or ROR, is applied to determine ComEd's profit levels.

ComEd would swiftly earn over \$1 billion in annual authorized profits.

Our first analysis considers what ComEd's annual authorized profits would be each year under the Omnibus Scenario. We found that ComEd would be approved for \$1 billion in authorized profits next year, which would be collected the year after, in 2023. This comes from \$951 million in authorized profits from distribution rates along with profits from regulatory assets that put the company's total authorized profits over \$1 billion. ComEd's authorized profits, without regulatory assets, would top \$1 billion the following year.

ComEd currently earns an authorized profit level of \$757 million from distribution rates, not including regulatory assets. In the Omnibus Scenario, ComEd's profit from distribution rates would jump by almost \$200 million in a single year.

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<sup>29</sup> Exelon Earnings Conference Call Fourth Quarter 2020, February 24, 2021, Slide 36. Available at: <https://investors.exeloncorp.com/static-files/2dda3a5d-b5c9-40d6-829f-da5c2efd6cc9>

While the actual new ratemaking structure, and therefore real profits jump, wouldn't begin until 2024,<sup>30</sup> this gives an idea of how much in additional profits the omnibus legislation may give ComEd, *each and every year*.

### Profits and increases in profits would dwarf previous periods

Our second analysis considers aggregate profits and increases in profits over four years under the Omnibus Scenario. They would dwarf profits and increases in profits over previous periods.

Over four years, 2021 through 2024, ComEd would be authorized to earn \$3.9 billion in profit under the Omnibus Scenario, not counting additional profits from regulatory assets. For reference, in the 12 years ComEd existed as an Exelon subsidiary before formula rates began, it reported \$3.9 billion in profit to the Securities and Exchange Commission.

Another illustration is the increase in ComEd's profits under formula rates. In 2020, ComEd's authorized profits are 50 percent higher than those approved in 2012, an increase of \$252 million. Under the Omnibus Scenario, ComEd's profits approved by the Commission would be 39 percent higher in 2024 than in 2020, an increase of \$387 million, a larger increase in raw dollars.

### ComEd would earn \$664 - \$893 million in additional profits over four years

Our third analysis compares aggregate authorized profits over four years under the Omnibus Scenario to two baselines. The Omnibus Scenario would deliver ComEd \$664-\$893 million in additional profits above the two baselines.

In Baseline One, we applied the overall Rate of Return as proposed in ComEd's current formula rate update docket, 5.72 percent, to the same ComEd rate base projections shared with Exelon investors. **Compared to Baseline One, under the Omnibus Scenario, ComEd would make an additional \$664 million in profits over four years.**

In Baseline Two, the rates ComEd customers are paying in 2021 would be frozen in place for the next four years--as if formula rates, including the annual formula rate update before the Commission now, ICC Docket No. 21-0367, were stopped. **Compared to Baseline Two, under the Omnibus Scenario, ComEd would make an additional \$893 million in profits over four years.**

That is almost \$900 million over *four years*, while the Exelon subsidy in the omnibus legislation is reported to be \$694 million over *five years*.<sup>31</sup> This means that were ComEd to enjoy a higher

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<sup>30</sup> At which point the Omnibus Scenario would equal, without adding any of the regulatory asset amounts, a jump of just under \$300 million.

<sup>31</sup> Dave McKinney & Tony Arnold, *New Energy Bill Pushed By Gov. JB Pritzker Would Save Nuclear Plants — But Cost Customers Nearly \$700 Million*, WBEZ, June 10, 2021.

ROE over the next four years, it would earn somewhere between \$166 million to \$223 million in additional profits per year. Exelon's subsidy would amount to "only" \$139 million per year.

Again, under the omnibus legislation, ComEd would not actually be collecting rates from customers based off of a higher ROE until 2024, so these findings are not predictive, but rather indicative of the future profits ComEd and Exelon could earn based on the best information currently available.

## Guaranteed profits would continue despite "consumer protections"

The omnibus includes language and provisions that may give the impression that the Annual Adjustment does not guarantee profits to the same degree that formula rates do. This includes language making clear the utilities "bear the burden of demonstrating that its costs were prudent and reasonable,"<sup>32</sup> and a provision that the Commission may not approve recovery of actual costs that are more than 105 percent higher than the Commission-approved revenue requirement from the multi-year rate plan.<sup>33</sup> These are not meaningful protections.

First, the burden is no different than the legal standards currently in place under formula rates. ComEd has repeatedly stressed in public statements that all its investments under formula rates were approved by the Commission under the same prudence and reasonableness legal standards.<sup>34</sup>

As we argued in [Guaranteed Profits, Broken Promises](#),<sup>35</sup> the formula rate *process* essentially flips the burden, but it does so through process, not an actual change to the applicable legal standards. While the process of formula rates is not completely carried over into the omnibus legislation, most notably not requiring a predetermined formula using data from the ComEd's FERC Form 1 as formula "inputs," its annual actual cost reconciliation architecture, as explained above, remains. Further, there is a meaningful difference between the Commission approving a level of costs for a typical year, as they do under traditional regulation, and ensuring that each and every dollar of investment spending, year after year, is prudent and reasonable.

Furthermore, the experience of annual reconciliations of the gas utilities' Rider QIP demonstrates it is exceedingly difficult to convince the Commission to deny recovery of investments after those investments have been made.<sup>36</sup>

Second, the omnibus legislation Annual Adjustment includes a mechanism under which the utility cannot recover more than 105 percent of the Commission-approved revenue requirement

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<sup>32</sup> Draft omnibus legislation, Section 16-108.18(f)(6) page 760.

<sup>33</sup> Draft omnibus legislation, Section 16-108.18(f)(6)(A)(ii) page 762.

<sup>34</sup> See, for example, the comments of ComEd President and Chief Operating Officer Terence Donnelly and General Counsel Veronica Gomez before the Chicago City Council Committee on Environmental Protection and Energy, June 10th, 2021.

<sup>35</sup> Abraham Scarr and Jeff Orcutt, *Guaranteed Profits, Broken Promises*, December 2020, 56.

<sup>36</sup> See ICC Dockets 16-0192, 16-0198, 17-0134, 17-0139, 18-0586, 18-0621, and 19-0271

from the multi-year rate plan. This may appear to protect consumers and force the utility to bear some risk of inefficient spending, but the protection it provides is minimal.

To begin, 5 percent is a lot of money. ComEd's annual revenue requirement, calculated using rate base additions they promised investors and their 2020 expenses and capital structure, would soon approach \$3 billion. Five percent of a \$3 billion in revenue requirement is \$150 million.

Additionally, the omnibus legislation includes numerous large loopholes for “volatile and fluctuating variables,”<sup>37</sup> making this cap all but meaningless, and shifting normal business and operational risks from the utility to ratepayers. Costs that according to the bill shall not be counted towards the cap include but are not limited to:

- “Weather-related events” such as storms and presumably heat-waves; thus customers are on the hook for costs due to weather (not just storms) that the utilities may not have properly prepared for;
- “New business,” a \$287 million cost<sup>38</sup> in 2019;
- “Facility relocations” — this vague category could include significant spending;
- “Amortization expenses related to costs” — though vague this seems to ensure customers, not the utility, would pay for any large unexpected company expenditures,<sup>39</sup> and due to the amortization these are costs off of which the utility can profit; and
- “Changes in the timing of when an expenditure or investment is made” — allowing utilities to move investments around in time to evade the caps, for example by making the earlier, front-loading profits, while filing in other investments later.<sup>40</sup>

All of these costs are risks that a normal business has to incorporate into their business model. Imagine if a normal business retroactively increased your bill from last year because of “volatile and fluctuating variables.”

These provisions in the omnibus bill that give some appearance of consumer protection fail to provide meaningful protection.

## Recommendations

While we would recommend further changes to the ratemaking policies within the omnibus legislation, and would note support for some policies, if the Illinois General Assembly wishes to completely end formula rates, it must amend the omnibus legislation to:

- Delete Section 16-108.25 “Tariff regarding transition in rates” and any references to it;

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<sup>37</sup> Draft omnibus legislation, page 762.

<sup>38</sup> ICC Docket 20-0393 ComEd Exhibit 5.03 page 1.

<sup>39</sup> Draft omnibus legislation, Section 16-105.6, page 613.

<sup>40</sup> Draft omnibus legislation, page 763.

- Delete subsection 16-105.18(f)(6), “Annual Adjustment” and any references to it;
- Adopt provisions from the Consumers and Climate First Act, HB4074 (Buckner) and SB2896 (Villanueva) amending 16-108.5:
  - Deleting the vague language allowing for some form of an actual cost reconciliation after formula rates otherwise sunset found on pages 618, 633, 649, and 651;
  - Moving the sunset date for formula rates to December 31, 2021, found on page 651. Another option would be to suspend current formula rate update dockets and maintain current rates until the new ratemaking structure begins.