

ILLINOIS COMMERCE COMMISSION

Staff Report to the Commission

December 14, 2015

Subject: Peoples Gas Light and Coke Company's ("Peoples" or "Company") compliance with Condition 5 of Appendix A to the Commission's June 24, 2015 Order in Docket No. 14-0496 and Illinois Commerce Commission reexamination of the Company's gas system modernization program

I. Executive Summary

On November 30, 2015, Peoples filed its report with the Illinois Commerce Commission ("ICC" or "Commission") to comply with a condition of the ICC's June 24, 2015, Final Order approving Peoples' acquisition by Wisconsin Energy Corporation ("Final Order"). The report outlines the estimated cost, schedule, and scope of the Peoples Gas Accelerated Main Replacement Program ("AMRP").

Peoples' report requests that the Commission consider removing the 2030 deadline to complete the AMRP, and instead implement a phased approach focusing on the next three years. During this time, Peoples said it would perform the most urgent work first to prioritize safety considerations and complete necessary upgrades to its gas distribution system.

Having thoroughly reviewed the report and the Company's request, Staff recommends several items for the Commission's consideration. As a highlight, Staff recommends that the Commission take the following key actions, among others:

1. Suspend the AMRP as it currently exists.¹
2. Stay any docketed proceedings, both current and future, related to Peoples' Rider QIP until the issues highlighted herein have been resolved.
3. Beginning in January 2016, convene a workshop/comment process open to all interested parties to address stakeholders' near-term and long-term recommendations for a new Peoples Gas system modernization program, including retaining a qualified consultant to advise the Commission in overseeing the new program.
4. Upon conclusion of steps further outlined below, Staff will issue a Staff Report on or before May 31, 2016, recommending that the Commission initiate a docketed proceeding to result in a Final Order with final and binding recommendations regarding the new program.

¹ As discussed further in Sections II and V below, the suspension relates only to the current AMRP, and has no bearing on the Company's existing and ongoing duty, pursuant to state and federal regulation, to repair, rehabilitate, and replace the highest-risk pipeline infrastructure in its jurisdiction.

II. Regulatory Background

a. The Commission's Focus on Safety

The ICC, through its partnership with the Pipeline and Hazardous Materials Safety Administration, has responsibility to ensure its natural gas operators meet the minimum Federal and state pipeline safety requirements in order to operate a safe system. Peoples must comply with these requirements despite any parameters established for its system modernization project. Commission Staff verify compliance by inspecting the pipeline design, construction, operation, and maintenance of natural gas facilities of the state's natural gas operators.

The Commission recognized the relationship between an accelerated program and operation of a safe system in its January 21, 2010 Order in Docket No. 09-0166/09-0167. In particular, the Commission noted accelerated system improvement has become a matter of the public interest.

b. The ICC's Pipeline Safety Program

The ICC's natural gas pipeline safety program operates in partnership with and under the authority of the Pipeline and Hazardous Materials Safety Administration.

In addition to carrying out pipeline safety responsibilities for the nine natural gas utilities that serve 3.8 million Illinois customers, the ICC's Pipeline Safety Program audits, records and conducts site visits for another 101 gas system operators, most of which are smaller municipal systems, and intrastate transmission systems. These 110 systems represent over 3.7 million individual service lines, over 61,000 miles of gas distribution mains and more than 3,000 miles of transmission lines.

The ICC, through its partnership with the Pipeline and Hazardous Materials Safety Administration, is committed to assuring the public that the 110 natural gas systems within its jurisdiction remain in compliance with the federal rules and are operating and maintained in a safe manner.²

c. U.S. Department of Transportation ("USDOT") and the Pipeline & Hazardous Materials Safety Administration ("PHMSA")

As noted above, the ICC's Pipeline Safety Program operates in partnership with and under the authority of PHMSA. PHMSA, created in 2004, is a USDOT agency. According to PHMSA's website:

"PHMSA develops and enforces regulations for the safe, reliable, and environmentally sound operation of the nation's 2.6 million mile pipeline transportation system and the nearly 1 million daily shipments of hazardous materials by land, sea, and air."

² See this page for more information the partnership between PHMSA and States' programs: <http://www.phmsa.dot.gov/pipeline/stateprograms>.

PHMSA's website provides an abundance of information regarding pipeline safety including alerts, guidance and statistics related to aging infrastructure. Following the San Bruno pipeline explosion in late 2010, USDOT and PHMSA issued a Call to Action "to engage all the state pipeline regulatory agencies, technical and subject matter experts, and pipeline operators to accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure."³

The below excerpt from the PHMSA website addresses aging pipelines and references the Call to Action, pipeline materials and age, replacement, and risk – terms familiar in Peoples Gas' main replacement program.

Aging pipelines

Pipeline transportation is one of the safest and most cost-effective ways to transport natural gas and hazardous liquid products. As the United States continues to develop and place more demands on energy transportation, it becomes necessary to invest in upgrading its infrastructure, including aging pipelines. In 2011, following major natural gas pipeline incidents, DOT and PHMSA issued a Call to Action to accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure. Among other factors, pipeline age and material are significant risk indicators. Pipelines constructed of cast and wrought iron, as well as bare steel, are among those pipelines that pose the highest-risk.⁴

III. Procedural History

a. WEC-Integritys Merger Final Order and Condition 5 of Appendix A

In its Final Order in Docket No. 14-0496, the Commission approved Wisconsin Energy Corporation's ("WEC") merger with Integritys and Peoples, subject to 47 conditions presented in Appendix A. One of these conditions, Condition 5, provides as follows:

Wisconsin Energy and Peoples Gas shall provide the Commission and its Staff with the following Improvement Plans within 75 days of this Final Order: 1) an implementation plan for each of Liberty's recommendations, 2) an AMRP scheduling master plan, 3) an AMRP cost plan model, and 4) an AMRP transition plan that provides detailed changes to the AMRP needed as a result of the

³ For additional information on the Call to Action, visit http://opsweb.phmsa.dot.gov/pipeline_replacement/action.asp.

⁴ See the full page here: http://opsweb.phmsa.dot.gov/pipeline_replacement/. In 2012, PHMSA issued an advisory bulletin to owners and operators of natural gas cast iron distribution pipelines, urging them "to conduct a comprehensive review of their cast iron distribution pipeline systems and replacement programs and to accelerate pipeline repair, rehabilitation, and replacement of aging and high-risk pipe" and "assure their replacement program models are based on relevant risk factors." PHMSA, Pipeline Safety: Cast Iron Pipe (Supplementary Advisory Bulletin), 77 Fed. Reg. 17119, 17120 (Mar. 23, 2012).

Reorganization in order to ensure a seamless transition that avoids a diminishment in service.

In the Final Order, the Commission directed Staff to report to the Commission on the progress of Peoples' plans by September 30, 2015:

As a part of the AMRP Audit process, Peoples is already required to provide 1) an implementation plan for each of Liberty's recommendations; 2) an AMR scheduling master plan; and 3) its cost plan model. In addition to those plans, Peoples and Wisconsin Energy will be required to provide 4) an AMRP transition plan that provides detailed changes to the AMRP needed as a result of the Reorganization in order to ensure a seamless transition that avoids a diminishment in service.

These four plans ("Improvement Plans") shall include updated, detailed information regarding appropriate size, scope, schedule, and cost for the AMRP. Wisconsin Energy and Peoples shall provide these Improvement Plans to the Commission and its Staff within 75 days of this Final Order. Staff will report to the Commission on the progress of these plans by September 30, 2015. The Staff report will be published on the Commission's website.

b. Peoples' Response to Condition 5

The Commission directed Peoples to provide the four plans identified in Condition 5 within 75 days of its Order, more specifically, by September 7, 2015.

On September 4, 2015, Peoples submitted a cover letter and compliance report to the ICC entitled, "*Peoples Gas Light and Coke Company's Compliance with Condition of Approval 5 from Illinois Commerce Commission Final Order in Docket No. 14-0496.*" The cover letter accompanying the compliance report stated that the report presented a consolidated implementation and transition plan "in compliance with" items 1 and 4 of Condition 5. The report further stated that Peoples intended to present plans for items 2 and 3 by November 30, 2015, attributing the delay primarily to a change in consultants assisting Peoples on the system modernization project.

c. Peoples' November 30th Report

On November 30, 2015, the Company submitted its response to parts 2 and 3 of Condition 5. The response, which can be found on the ICC's e-docket page in Docket No. 14-0496, includes a cover letter, an Executive Summary and a report entitled "Program Level Cost Forecast and Schedule Model" prepared for Peoples Gas by Burns & McDonnell Engineering Company.

The Company's November 30th submission emphasizes:

- Safety and efficiency
- New management's "fresh look" at the program, strict cost controls, greater efficiency

- A recommended three-year plan, rather than a firm date for AMRP completion, during which the Company's program will focus on "the most urgent work needed to improve the safety and efficiency of its natural gas delivery network", gas transmission upgrades, and project coordination with the City of Chicago
- Quarterly reports to keep the Commission informed of the project's activity and an annual progress
- Expected three-year investments totaling \$800 million (\$250-\$280 million per year, or approximately 2.8% annual increase in a typical customer's bill)
- New cost plan models and scheduling master plans (prepared by Burns & McDonnell to satisfy merger condition 5's items 2 and 3) assuming completion by 2030 and 2040.

i. Burns & McDonnell's Program Level Cost Forecast and Schedule Model

In September 2015, Peoples retained Burns & McDonnell ("B&M") to develop a cost forecast and schedule model for the remaining work. Peoples directed B&M to provide it with an editable/updateable model for use by in-house Peoples Gas staff to support their ability to track and trend future program activities and costs. B&M created the cost forecast and schedule model after conducting interviews with representatives from the involved company departments and reviewing data and information about past, present, and future system modernization capital projects. Further, B&M developed models for completion dates of 2030 and 2040. Finally, B&M populated the cost forecast and schedule models with various factors, unit costs, historical data, and considered uncertainties as well as efficiencies to assign a cost range.

Staff's initial review of the Company's new cost forecast and schedule model found reasonable the iterative process that B&M used to develop the models for the program's costs and schedule. Staff is at the preliminary stage of its review and will later provide an analysis of the supporting documentation used to develop these models. Staff found that B&M's use of unit costs, historical data, and especially the consideration of uncertainties and efficiencies appear to address some of the major planning gaps that the Liberty Consulting Group ("Liberty") found during its Phase I investigation of Peoples' system modernization project. Staff views this process improvement as a major step towards executing the project more efficiently and reasonably. With B&M's and Peoples' recognition of cost and schedule drivers, B&M was able to develop several different scenarios in which the project may be executed and completed by 2030 or 2040. Staff also found useful B&M's approach of providing Peoples with items for Peoples to consider while restructuring the project.

Notwithstanding the improvements in the process, Staff notes the time constraints within which B&M developed these models. Further, the only reliable data B&M seems to have is historical project data and interviews with representatives

departments involved in the project. B&M notes there is no comparable industry data to which it could compare Peoples' historical project data. Further, B&M also admits due to time constraints that it was unable to perform a comprehensive risk analysis, which required it to assign contingencies to all major items to address cost risk.

ii. Peoples' Distinction Between Pre-acquisition and Post-acquisition Approaches to AMRP

At the core of the Company's "fresh start" is its "improved management and execution of the program." The Company's expected results include:

- Improved long-term cost and schedule forecasts
- Focus on the most urgent work over the next three years
- Strict cost controls and greater efficiency
- Reduced customer and City frustration with restoration delays
- Coordination with the City on new construction methods to improve restoration
- New construction agreements with contractors
- Cost improvements during the next three years and in the long-run

iii. Peoples' Recommendation to Focus on a Three-Year Plan

Peoples Gas recommends the Commission allow new management the opportunity to demonstrate the benefits of the proposed three-year plan in place of retaining the existing firm date or establishing a new firm date for program completion. The Company proposes the Commission revisit the question of a targeted completion date after considering the results of new management's execution of the program during the three-year period. During that time, the Company will continue to provide quarterly reports to keep the Commission informed of current activity as well as annual progress updates.

IV. Additional Procedural Considerations

a. The Liberty Consulting Group's Assignment

In Docket No. 12-0511/12-0512 (consol.), the Commission recognized the need for an outside consultant to review Peoples' system modernization program. In May 2014, Staff awarded the contract to review Peoples' program to The Liberty Consulting Group. The engagement involved two parts, Phase One with a one-year duration and Phase Two with a two-year duration.⁵

In Phase One, Liberty was required to make findings, conclusions, and recommendations to improve Peoples' system modernization program and to help ensure that Peoples completed the project in the shortest reasonable time and at the lowest reasonable cost. Phase One also involved Liberty providing recommendations

⁵ Liberty's reports related to the Peoples Gas AMRP investigation are posted to the Commission's website: <http://www.icc.illinois.gov/NaturalGas/NaturalGasInvestigations.aspx>.

to the Commission to help monitor the project, including its cost and its schedule. Liberty completed Phase One with its May 5, 2015 Final Report to the Commission. Liberty's Phase One Report contained 95 recommendations.

In Phase Two, Liberty must verify that Peoples has implemented its Phase One Report recommendations. Liberty must also provide to the Commission its findings and conclusions regarding Peoples' efforts and success in implementing its recommendations from the Phase One investigation and provide additional recommendations, as appropriate, to help the Commission monitor Peoples' project, its cost, and its schedule through completion.

b. Attorney General and Citizens Utility Board Petition to Investigate/Restructure AMRP

On November 9, 2015, The AG and CUB filed a Petition "for an Expedited Investigation and Restructuring" seeking Commission action to open an investigation into the restructuring of the Company's system modernization project. The Petition raises concerns that overlap to some extent with the issues in this Staff Report, but is otherwise outside the scope of the Report. The Petition is pending before the Commission, and therefore Staff does not take a position on the relief requested therein.

c. Rider QIP

The Commission approved Peoples Gas' Rider QIP in Docket No. 13-0534, which implemented the surcharge approved by the General Assembly in 220 ILCS 5/9-220.3. Peoples implemented the rider in 2014, with charges to ratepayers beginning in March 2014 for investments placed in service in January 2014. Qualifying investments primarily include replacing cast iron and ductile iron pipe, and upgrading from low to medium pressure facilities. In March 2015, Peoples Gas filed its first reconciliation petition for Rider QIP, Docket No. 15-0209. The reconciliation contains an internal audit requirement. Peoples requested until December 31, 2015 to complete certain audit reviews, therefore the reconciliation proceeding remains in progress.

V. Staff's Recommendations

Staff offers the following recommendations for the Commission's consideration:

1. **Suspension of the AMRP program as it currently exists.** As part of the Commission's reexamination of the Company's gas system modernization program, Staff recommends suspending the AMRP until the Commission has had the opportunity to analyze the information gathered through the stakeholder process outlined below. Staff stresses that although regulatory

oversight is being rethought, Peoples remains bound by its state and federal duties to ensure pipeline safety.⁶

2. **Stay of Peoples' Rider QIP reconciliation proceedings.** Staff recommends that the pending reconciliation proceeding (docket no. 15-0209) and any future proceedings related to Peoples' Rider QIP be stayed and any Commission action deferred until the issues in this Staff Report have been resolved.
3. **A workshop/comment process open to all interested parties.** Beginning in January 2016, Staff will convene workshops and a comment process that will conclude with a Staff Report dated on or before May 31, 2016 that addresses stakeholders' near-term and long-term recommendations for Peoples Gas' system modernization project, and proposes that the Commission initiate a docketed proceeding to result in a Final Order with final and binding recommendations regarding the new program. The process will include at least six workshops organized in this manner, and subject to change based on stakeholder input and progress:
 - Workshop #1, week of January 11th: This workshop will focus on participants' comments on workshop agendas and schedule, and includes a discussion of Peoples' system modernization activities during program reevaluation and project scope. Specific topics include:
 1. Stakeholders' recommendations for future workshop agendas including topics and schedule.
 2. Schedule, pace and scope of the project in the near-term.
 3. Invitation to the Company to present and describe its three-year plan as proposed in its November 30th submission, including its plans regarding the project's schedule, reporting and monitoring, safety, and reliability.
 4. The project's three parts: replacement of at-risk facilities, switch from low to medium pressure, and moving meters outside.
 5. A description of the Company's plan to address a situation in which a pipeline that has not been scheduled for replacement becomes a concern warranting immediate replacement.
 6. The neighborhood, or zonal, approach.
 7. Project scope and its impact on safety and reliability.
 8. Scope control: identifying, analyzing and measuring impact of program/project changes.

⁶ See Section II above.

- Workshop #2, week of January 25th: This workshop will focus on coordination of Peoples' system modernization program with the City of Chicago ("the City"). Specific topics include:
 1. Invitation to the Company and Chicago Department of Transportation to present and describe the joint planning and activities regarding their respective improvement projects.
 2. Coordination with the City and the impact on the gas system modernization project's schedule, plans and costs.
 3. The impact of the City's permitting process related to ranking and completing projects.
 4. Safety and reliability considerations when coordinating with the City.

- Workshop #3, week of February 8th: This workshop will focus on the project's pace and optimal schedule. Specific topics include:
 1. U.S. DOT/PHMSA call for gas system operators to "accelerate the repair, rehabilitation, and replacement of the highest-risk pipeline infrastructure."
 2. New management's plan for scheduling the program and projects within the program.
 3. The pros and cons of a firm end-date, firm interim dates, and short and long-term targets.
 4. Risk assessment tools: Main Ranking Index, leak tracking, coordination with the City, the neighborhood approach.

- Workshop #4, week of February 22nd: This workshop will focus on the project's cost estimate and how QIP is used to finance the project. Specific topics include:
 1. Invitation to Burns & McDonnell to present on the development of a new cost model.
 2. The long-term and short-term costs of the program and individual projects.
 3. The impact of the QIP Rider's limits and rules on safety, reliability and the pace of the project.
 4. Combining QIP recovery and rate case recovery when designing the program.
 5. Determining and factoring customer affordability into the program.

- Workshop #5, week of March 7th: This workshop will focus on the Commission's ongoing monitoring of the project. Specific topics include:
 1. Monitoring the project's plans, progress, costs and success in reducing safety risk.

2. The purpose and goals of a monitoring program.
 3. Flexibility and transparency of a monitoring program.
 4. Frequency and content of Company reports required to support a monitoring program.
 5. The Company's methods for performance analysis.
 6. Reliance on outside consultants.
 7. Monitoring contractors' work performed and work charged to a project.
 8. The role of the PUA Section 5-111 annual metrics report for natural gas utilities in a monitoring program.
- Workshop #6, the week of March 21st: This workshop will focus on customer considerations, summary and next steps. Specific topics include:
 1. Customer communications, scheduling, and problem resolution.
 2. Staff Report summarizing workshops and participants' comments
 3. Next steps.
- Staff will present a workshop process status report in advance of the Commission's February 24th and March 23rd regular open meetings.
 - Staff and the Company will participate and stakeholders will be invited to participate in a Policy Meeting in April 2015 to discuss progress.
 - Anticipating the services of an outside consultant to advise the Commission in overseeing the program, Staff will immediately begin the procurement process.
 - Pursuant to PHMSA's Call to Action and Advisory Bulletin, the Commission should direct the Company to repair, rehabilitate, and replace the highest-risk pipeline infrastructure, and assure its replacement program model is based on relevant risk factors.

Prepared by:

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