STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTHERN ILLINOIS GAS COMPANY D/B/A NICOR GAS COMPANY Proposed general increase in rates, and revisions to other terms and conditions of service.	: : : : : :	No. 04-__________

Direct Panel Testimony of

GERALD P. O'CONNOR, FCCA

Vice President, Finance and Administration

Northern Illinois Gas Company

and

ALBERT E. HARMS

Manager, Rate Research

Northern Illinois Gas Company

Nicor Gas Exhibit 12.0

Q. Please state your names.

A. Gerald O'Connor and Albert E. Harms.

Q. What are your business addresses?

A. We have the same business address, which is 1844 Ferry Road, Naperville, Illinois. 60563.

Q. Mr. O'Connor, by whom are you employed and in what position?

A. I am the Vice President, Administration and Finance of Nicor Inc. ("Nicor") and of Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the "Company").

Q. Mr. Harms, by whom are you employed and in what position?

A. I am the Manager, Rate Research, of Nicor Gas.

Q. What are the purposes of your panel direct testimony?

A. The purposes of our panel testimony are to:

- Present the proposed revisions to Nicor Gas' tariff sheets, including revisions to the Nicor Gas' rates, riders, and terms and conditions of service.

- Explain and support the proposed amendments to Nicor Gas' tariff sheets <u>other than</u>: (a) the changes in the Company's service classifications and the calculation of most of the charges for utility services that are based on changes in Nicor Gas' proposed base rate revenue requirement and on the results of Nicor Gas' cost of service studies; and (b) most changes relating to storage and supply operations.

The proposed changes that we address in this testimony include revised non-revenue terms, updated charges not based on the overall revenue requirement (*e.g.*, dishonored check fees), revisions to the Company's gas supply cost mechanism, and modifications to Nicor Gas' general terms and conditions of service. Organizationally, our testimony is divided into discussions of proposed amendments to the Company's: (a) Rates; (b) Rider 6 – Gas Supply Cost ("Rider 6"); (c) other Riders; and (d) Terms and Conditions of service.

The derivation of the Company's base rate revenue requirement and the applicable billing determinants, their allocation to various service classifications, and the calculation of appropriate charges, based on the overall revenue requirement, for the services rendered to customers in those classes is the subject of direct testimony submitted by other witnesses, including principally: the panel of Messrs. Gerald O'Connor and James Gorenz (Nicor Gas Exhibit 11.0), Mr. Albert Harms (Nicor Gas Exhibit 17.0), Drs. Hethie Parmesano and Cesar Herrera (Nicor Gas Exhibits 13.0 and 15.0, respectively), and Mr. Alan Heintz (Nicor Gas Exhibit 14.0). Matters relating to storage and supply operations are principally addressed in the testimony of Mr. Gary Bartlett (Nicor Gas Exhibit 8.0).

Q. Please briefly describe the exhibits attached to your testimony.

A. There are seven exhibits attached to our testimony.

- Nicor Gas Exhibit 12.1 is the tariff sheets that Nicor Gas has filed with the Illinois Commerce Commission (the "Commission") and that are the subject of this proceeding.
- Nicor Gas Exhibit 12.2 shows in "legislative" style the differences from the Nicor Gas tariffs currently on file.
- Nicor Gas Exhibit 12.3 consists of workpapers supporting and showing the derivation of the Administrative Charges discussed in our testimony.
- Nicor Gas Exhibit 12.4 consists of workpapers supporting and showing the derivation of the Recording Device Charges discussed in our testimony.
- Nicor Gas Exhibit 12.5 consists of workpapers supporting and showing the derivation of the Group Change Fees discussed in our testimony.

- Nicor Gas Exhibit 12.6 consists of workpapers supporting and showing the derivation of the Non-Common Ownership Group Fee discussed in our testimony.
- Nicor Gas Exhibit 12.7 consists of workpapers supporting and showing the derivation of the Excess Storage Balance Transfer Fee discussed in our testimony.

Background and Qualifications

Q. Mr. O'Connor, are you the same Gerald O'Connor who has also provided to the Commission in this Docket direct panel testimony with Mr. Richard Hawley (Nicor Gas Exhibit 1.0)?

A. Yes, I am. My position and duties with Nicor Gas, as well as my background, education, and career experience are described in that testimony.

Q. Mr. Harms, what are your duties as Manager, Rate Research for Nicor Gas?

A. As Manager, Rate Research, I am responsible for managing the study, analysis, and development of Nicor Gas' rates, including the proposed revisions in Nicor Gas' rates, which are the subject of this proceeding. My department's duties do not include Company financial forecasting and reporting, but do include assessing the effect forecast and reported financial and other data have on rates and costs of service. My department is also responsible for the maintenance of public records relating to the tariffs on file with the Commission.

Q. Mr. Harms, please summarize your professional and educational background.

A. I have been employed by the Company since 1972. I began my employment as a rate analyst in the Rate Research section of the Rate Department. I later held management positions in the Marketing, Customer Service, Credit, and Finance Departments. I have managed the Rate Department since May of 1988.

I hold a Bachelor of Arts degree, majoring in Mathematics, from Taylor University in Indiana and a Master of Business Administration degree from Northern Illinois University.

<u>Nicor Gas' Proposed Tariffs</u>

Q. Please identify Nicor Gas Exhibit 12.1.

A. Nicor Gas Exhibit 12.1 includes true and correct copies of the tariff sheets Nicor Gas has filed with the Commission that are the subject of this proceeding. The proposed tariff sheets implement a number of revisions, updates, and improvements to Nicor Gas' tariffs, as well as providing for a just and reasonable allocation of the Company's increased revenue requirement to its customers and charges.

Moreover, as a convenience to the Commission and the parties, Nicor Gas Exhibit 12.1 includes the unchanged tariff sheets as well. It thus represents how the Company's Schedule of Rates would appear with all filed changes being made. As shown on this Exhibit, Nicor Gas filed its proposed tariffs as revisions to ILL. C.C. No. 16, Nicor Gas current schedule of rates, rather than as a new, replacement rate schedule.

Q. Please identify Nicor Gas Exhibit 12.2.

A. Nicor Gas Exhibit 12.2 shows, in legislative or "redline" style, the changes that the newly filed sheets would make to the Nicor Gas Schedule of Rates that was effective as of the time of the filing. The "redlines" included in Nicor Gas Exhibit 12.2 are provided as an aid to the understanding of the amendments the Company proposes, and for the convenience of the Commission and the parties. As with Nicor Gas Exhibit 12.1, we have included the entire schedule of rates in Nicor Gas Exhibit 12.2, not just those sheets on which there are changes.

Q. What action does Nicor Gas request the Commission take with respect to these proposed tariffs?

A. Nicor Gas requests that the Commission permit these tariffs to become effective or, if the Commission suspends them, that the Commission, after appropriate proceedings, finds that the tariffs are just and reasonable and approve their going into effect.

Nicor Gas requests that, with only a few specific exceptions driven by operational needs, revised charges and other provisions should apply to services rendered to each customer beginning with the effective date of the tariffs. Each of the exceptions will be discussed in our testimony below or, in the case of Rate 21, Intrastate Transportation and Storage Services ("Rate 21"), in the testimony of Mr. Gary Bartlett (Nicor Gas Exhibit 8.0). Where the effective date does not correspond with a customer's billing day, the charges will be prorated.

Revisions to Rates

Service Territory

Q. Please direct your attention first to revised Sheets Nos. 2-9 included in Nicor Gas Exhibit 12.1. Please describe what revisions Nicor Gas is proposing and explain why the changes should be approved by the Commission.

A. Sheet Nos. 2-9 have been revised to reflect the list of incorporated and adjacent unincorporated municipalities in which Nicor Gas provides utility service. Since the last rate case, new municipal corporations have been formed within Nicor Gas' service territory and these revisions update the schedule of rates to reflect those municipalities and the unincorporated areas adjacent thereto. The revisions do not reflect an expansion of Nicor Gas' overall service territory.

Charges Based on Overall Cost of Service

Q. As part of its overall rate proposal, Nicor Gas has presented evidence supporting and quantifying an increased jurisdictional base rate revenue requirement and studies of its costs of service. Please summarize which revisions to the charges reflected in Nicor Gas' proposed tariff sheets are based on that updated overall cost of service.

A. The Company is proposing to update the customer charges and various distribution and storage-related charges in its standard sales and end user transportation rates. These charges include: the customer and distribution charges in Rates 1, 4, and 74; the customer, distribution, gas supply, and minimum monthly charges in Rates 6 and 76; and the customer, demand, gas supply, commodity, and minimum monthly charges in Rates 7 and 77. These updated charges are based on Nicor Gas' updated cost of service studies. These studies, the derivation of the charges, and allocation of Nicor Gas' cost of service to the various rates and charges is supported by and discussed principally in the testimonies of Mr. Harms (Nicor Gas Exhibit 17.0), Dr. Parmesano (Nicor Gas Exhibit 13.0), Mr. Bartlett (Nicor Gas Exhibit 8.0), and Mr. Heintz (Nicor Gas Exhibit 14.0).

Q. Other than reflecting its changed overall cost of service as you have testified, does Nicor Gas propose any revision to its standard sales and/or transportation tariffs, *i.e.*, Rates 1, 4, 6, 74, 76, and 77?

A. Yes. Nicor Gas proposes to localize the recovery of franchise costs imposed by municipalities and other units of local government, so that the franchise costs imposed by any specific unit of government are paid by the customers taking service within the boundaries of that same unit of government. The Company's proposal is discussed in more detail later in our testimony. The removal of these costs from the base rate revenue requirement paid by all customers regardless of location results in the calculation of lower charges for our base rates than would otherwise be applicable. However, due to billing issues, Nicor Gas cannot implement this proposal until January 1, 2007. Therefore, alternative distribution charges are included in Nicor Gas' proposed Rates 1, 4, 6, 7, 74, 76, and 77 (Nicor Gas Exhibit 12.1, Sheet Nos. 10, 11, 12, 13, 19, 22, and 25) that reflect, before January 1, 2007, the inclusion of these costs on a common system-wide basis and, after that date, the removal of these costs from base rates and their recovery through Rider 7. If the Commission should deny the Company the localization sought in its proposed revisions to Rider 7, then the higher pre-2007 charges would continue to apply.

Q. Are there any other revisions proposed to the Company's standard sales and/or transportation tariffs, *i.e.*, Rates 1, 4, 6, 74, 76, and 77?

A. Yes. Under Nicor Gas' transportation Rate 74, 76, and 77 and under Rider 25, Firm Transportation Service, customers can request the Company to provide Firm Backup Service ("FBS"). That is, customers can elect a quantity of gas that they want the Company to be prepared to provide to them from the supplies that the Company purchases. The Company reserves space on inter-state pipelines by paying demand charges and passes these costs on to customers through the Gas Supply Cost mechanism ("GSC") implemented in Rider 6. These demand charges are reflected in a GSC charge called the "Demand Gas Cost" ("DGC"). Customers under Rates 6 and 7 sales service, and under Rider 25 have 100% of their load requirements available from the Company. As a result, they have been paying 40% of the DGC (*see* Nicor Gas Exhibit 12.1, Sheet

Nos. 12, 13, and 76). The 40% reflected the Company's past reliance on pipeline gas to meet its peak day requirements. Since the Company's 1995 general rate proceeding, ICC Docket No. 95-0219 (the "'95 Rate Case"), the Company's reliance on pipeline gas for meeting peak day needs has changed and, as a result the proportion of the DGC that should be paid by such customers has risen to 53%. This proposal is implemented through an amendment to Rates 6 and 7 (at Nicor Gas Exhibit 12.1, Sheet Nos. 12 and 13) and to Rider 25 (*id.*, Sheet No. 76).

Q. Does Nicor Gas propose any additional revisions to its standard sales and/or transportation tariffs?

A. The Company proposes increasing the minimum bill amount under Rates 6, 7, 76, and 77 (Nicor Gas Exhibit 12.1, Sheet Nos. 12, 13, 24, and 27) to maintain the same therm level for breaking even given the present and proposed charges under these rates. The derivation of those charges is addressed in the testimony of Mr. Harms (Nicor Gas Exhibit 17.0).

Q. Does Nicor Gas propose any additional revisions to its transportation tariffs based on a changed cost of service?

A. Yes. The Company proposes to update the costs of Storage Banking Service ("SBS") used by customers taking service under our end user transportation rates, Rates 74, 76, and 77. These charges appear on Sheet Nos. 19, 22, and 26 of Nicor Gas Exhibit 12.1.

Q. Please describe the calculation of the Company's proposed charge for selecting SBS.

A. The SBS calculation, as described further in the testimony of Mr. Harms (Nicor Gas Exhibit 17.0), is based upon the embedded costs of storage, as measured by the

Embedded Cost of Service Study ("ECOSS") presented in this case (Nicor Gas Exhibit 14.1). Specifically, the charge is based on the allocated cost of storage divided by the amount that can be cycled annually. Specifically, the allocated cost of storage excluding top gas is $ 54,967,000 (Nicor Gas Exhibit 14.1, Schedule E). Top gas storage costs are excluded from the derivation of the charge because transportation customers provide their own inventory. This annual cost is divided by the amount being cycled annually, which is 120 Bcf.[†] The calculation yields a price of 4.58 cents per therm annually or 0.38 cents per therm per month.

Rate 10

Q. Nicor Gas Group Exhibit 12.1 reflects the cancellation of Rate 10, Compressed Natural Gas. Why should this rate be cancelled?

A. Rate 10 should be cancelled, and the customers taking service thereunder transferred to service under Nicor Gas' Rate 4, for several reasons. Rate 10 is available only for a limited use, that is, compressed natural gas ("CNG"). The Company believes that, as a general matter, rates that are based on the type of use should be eliminated. The type of use alone rarely, if ever, affects the Company's costs. Rather the customers' usage patterns, and resulting required capital investments and expenses, should be reflected in a cost-based rate that reflects appropriate charges.

In addition, Rate 10 no longer has any appropriate purpose. There is little customer interest in the service, and no demonstrated interest in the expanded use of CNG as a vehicle fuel, which the rate was intended to support.

[†] The same amount of storage being annually cycled is used in the calculation of the storage capacity and withdrawal entitlement, discussed later in our testimony.

Finally, preserving Rate 10 would continue a subsidy that is not justified by any cost of service differential, and which could be eliminated with little customer impact.

Q. Please explain why Rate 10 no longer has an appropriate purpose.

A. Rate 10 was developed and approved in the early 1980s as a promotional rate to encourage what was then forecasted to be a growing market for the use of CNG as a motor fuel through a comparatively low volumetric charge. The low volumetric charge was not related to any reduced cost of delivery. Nonetheless, Rate 10 was continued through the 1990s as a rate that attempted to further efforts to meet certain federal clean-air mandates initiated in the mid 1990s, largely affecting fleet vehicles, which required phased-in use of alternative fuels. Because natural gas was, at that time, considered to be comparatively inexpensive among the environmentally-friendly options, vehicles fueled by CNG were initially thought to play a major role in this solution. Rate 10 was also viewed as a means of efficiently collecting on-road motor vehicle taxes applicable to CNG-fueled vehicles.

However, both the market and the regulatory environment have changed and no longer justify the departure from cost-based ratemaking that Rate 10 represents. First and foremost, CNG vehicles have not developed as anticipated for reasons unrelated to Nicor Gas' rates. Initially, two pieces of federal legislation paved the way for the use of natural gas as a motor fuel. The Clean Air Act Amendments mandated, on a phased-in basis, automobile manufactures to produce vehicles with lower tailpipe emissions. However, advances in vehicle engine efficiencies and reformulated gasoline met the bulk of this emission challenge. Moreover, the National Energy Policy Act addressed the accelerated phase-in of new vehicle purchases for the operators of government fleets and alternate-fuel service providers. Today, the federal guidelines regarding alternative fuels have been revised, while more technological and market attention has been being given to promising hybrid-electric and hydrogen-fueled designs. In addition, higher than forecast and volatile natural gas costs, as well as comparatively low inflation-adjusted gasoline prices, have largely eliminated the CNG market, as other alternative fuels and technologies have met a greater share of fleet requirements.

Likewise, the hope that Rate 10 would contribute to more efficient tax collection has not materialized. Rate 10 candidates turned out to be largely government and municipal agencies who were required to meet the new alternate requirements and were tax exempt. Rate 10 did not help these customers streamline any of their tax issues.

As a result of these factors, and perhaps others, there are now only 13 subscribed customers, and only eight active customers under Rate 10. There is no demonstrated interest in increasing the use of CNG as a fleet vehicle fuel, and no expressed interest whatsoever in increasing the number of customers taking service under the rate. Thus, the justifications for the rate are no longer valid.

Q. Does the subsidy implicit in Rate 10 also support its cancellation?

A. Yes. There is no difference in the cost of service (marginal or embedded) that can justify the difference in the volumetric charge. Given that the purpose of the lower volumetric charge – to simulate interest in what was then assumed to be a growing CNG auto-fuel market – is obsolete, Rate 10 simply results in an unsupported and inappropriate inter-class subsidy.

Q. What other factors did the Company consider in making this recommendation?

A. Our analysis shows that Rate 10 can be eliminated with comparatively small impact on any existing customers or the Company. As noted, there are only eight active customers on Rate 10. Placing these customers on the sales or transportation rate appropriate to their size would result in only a modest change in their overall gas service cost. On a comparative basis, when including a customer's commodity gas cost, calculated using either the Company's Gas Supply Cost for sales customers or the First of Month Price Index for natural gas for transportation customers, the overall total increase in gas costs for these customers would average about 6%. Including the Company's proposed increase, their cost increase would average about 10%.

Q. Are there any other changes to Nicor Gas' rates required to effect the cancellation of Rate 10?

A. Yes. The language in Terms and Conditions, under "Natural Gas Used as a Motor Vehicle Fuel," (Nicor Gas Exhibit 12.1, Sheet No. 36) must be revised to reflect the cancellation of Rate 10. That change is reflected in the revised tariff Nicor Gas is proposing. Likewise, the section of Terms and Conditions that deals with bi-monthly bills (*id.*, Sheet No. 39), and the applicability sections of Rider 12 – Environmental Cost Recovery (*id.*, Sheet No. 68) and Rider 25, Firm Transportation Service (*id.*, Sheet No. 76) should be revised to delete any reference to Rate 10.

<u>Rates 11 & 81</u>

Q. Does Nicor Gas propose to eliminate any other service classifications?

A. Yes. The Company proposes to eliminate Rates 11 and 81, which are special sales and transportation rates applicable to "Energy Service (Cogeneration)", that is, to gas used as the fuel for operation of a gas engine or turbine producing mechanical or electric energy used by the customer, or any qualifying co-generation installation. These are also "type of use" rates that, as we testified above, should in general be eliminated. Customers now taking service under Rate 11 would be appropriately served under Rate 4, and customers taking service under Rate 81 would be served under Rates 74 or 76.

Q. What is the current status of Rates 11 and 81?

A. These rates are in the process of being phased-out. The addition of new customers to Rates 11 and 81 was prohibited in the '95 Rate Case. At that time, the then existing Rates 11 and 81 customers were "grandfathered" into their respective rate, and the rates were closed to any new customers. Today, the rates remain in use only by those grandfathered customers who have not voluntarily elected service under a different rate or otherwise ceased taking service from the Company. In this filing, Nicor Gas proposes to complete the phase-out of these service classifications and to cancel these rates.

Q. Why should these rates be cancelled?

A. Rates 11 and 81 were developed as promotional marketing rates to encourage the use of natural gas as fuel for on-site generation of electricity or "Combined Heat and Power" production. Rates 11 and 81 were developed to make self-generation more economically viable, while still covering the Company's variable costs and making a contribution to fixed costs. To do that, Rates 11 and 81 offered a competitive monthly customer charge combined with a fixed lower volumetric charge and, as a result, customers under these rates made a lower contribution to fixed costs than similar customers not eligible for these rates.

At the rates' inception, this made economic sense. The rates permitted customers to use relatively inexpensive self-generation as a hedge against the more common effects of electric power interruptions. There is no remaining rationale for this market to be subsidized. Moreover, the combination of higher gas costs, stable electric rates, and improved electric reliability have stagnated this market. Nicor Gas will continue to serve this market, on a "level playing field" basis, with rates based on the cost of service to these and similarly situated customers.

Q. What would be the impact on the remaining Rates 11 and 81 customers of eliminating these rates?

A. We believe that Rates 11 and 81 can be eliminated with a comparatively small overall impact on the gas service costs incurred by existing customers. Canceling Rate 11 affects 55 active accounts; canceling Rate 81 affects 32 active accounts. Migrating customers to other applicable rates would result in decreased total charges to more than 50 customers, and increased charges to only 36, all other things being equal. Moreover, of those customers who are likely to experience increased charges, the average increase, before proposed rate increases and including the cost of gas, is about 6.7% for the Rate 11 customers and about 3.4% for the Rate 81 customers.

Q. Are there any other changes to Nicor Gas rates required to effect the cancellation of Rates 11 and 81?

A. Yes. The section of Terms and Conditions that deals with bi-monthly bills (Nicor Gas Exhibit 12.1, Sheet No. 39) and the applicability section of Rider 25, Firm Transportation Service (*id.,* Sheet No. 76) should be revised to delete the reference to Rate 11. Also, the references to Rates 11 and 81 should be removed from the applicability section of Rider

12, Environmental Cost Recovery (*id.*, Sheet No. 68). Finally, the references to Rate 81 should be removed from the Terms and Conditions applicable to transportation rates and from Rider 13, Supplier Transportation Service (*id.*, Sheet No. 71).

<u>Rate 21</u>

Q. Please describe the purpose and effect of Rate 21.

A. Rate 21 permits the Company to offer Illinois-jurisdictional intrastate transportation and storage services on an interruptible basis. Analogous services subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") are offered pursuant to an operating statement on file with the FERC. The services, often referred to as "Hub" services, include "parks" (the storage of customer gas in Nicor Gas facilities), "loans" (the temporary use of Nicor Gas' gas by customers, currently allowed only for inter-state transactions), associated transportation, and other transportation services across the Nicor Gas system.

Offering these services permits the Company to: meet customer demand for storage and transportation service on and through the Nicor Gas system; assist Customer Select suppliers in efficiently managing their supply obligations; promote a liquid and transparent market at the Chicago Hub and the Nicor Gas city gate; secure operational and economic benefits through more efficient and conservative use of Nicor Gas' storage assets; and secure economic advantages to Nicor Gas' other sales and end-use transportation customers through a reduction in the revenue required to be generated by other rates and charges. The nature of these services, the operation of the Hub, and the benefits of offering these services at reasonable rates are all discussed more fully in the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0), and are summarized in this testimony for the purpose of describing the tariff only.

Q. Please summarize the changes Nicor Gas proposes to make to Rate 21.

A. Nicor Gas proposes to reduce the differences between Rate 21 and the Company's FERC tariff applicable to analogous inter-state services. The principal changes the Company proposes would:

- Clarify that loans are permitted for intra-state, as well as, inter-state transactions;
- Permit intra-state transactions to remain open for longer than 120 days;
- Permit Nicor Gas to offer intra-state services with different levels of firmness, including priority interruptible service and, under specific circumstances, firm services, with firmer services being subject to non-refundable reservation charges.

These changes are discussed and supported by the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0). Nicor Gas also proposes updated maximum charges for Rate 21 service. These charges are discussed and supported by the testimony of Mr. Harms (Nicor Gas Exhibit 17.0).

Finally, Nicor Gas also proposes a significant change in the manner in which revenues from Rate 21 (and analogous FERC-jurisdictional Hub services) are treated. Nicor Gas proposes that all revenues from such services, net of the cost to the Company of providing them, should be credited against costs of gas that would otherwise be recovered through Rider 6. This is further discussed later in this testimony, and in the panel testimony of Messrs. Hawley and O'Connor (Nicor Gas Exhibit 1.0) and the testimonies of Mr. Gary Bartlett (Nicor Gas Exhibit 8.0) and Dr. Kenneth Gordon (Nicor Gas Exhibit 2.0). The effect of this change on other charges is also addressed in the testimony of Mr. Harms (Nicor Gas Exhibit 17.0).

End User Transportation Rates

Q. Other than reflecting the Company's changed overall costs of service as you have testified, does Nicor Gas propose any revision to its standard end user transportation tariffs, *i.e.*, Rates 74, 76, and 77?

A. Yes. The Company proposes to update various administrative and recording device (metering) charges. We propose changes to withdrawals for Storage Banking Service and Customer Select Critical Day deliveries to better reflect Nicor Gas' operational requirements and characteristics. We also propose to strengthen the incentives for end use transportation customers to seasonally cycle their use of Nicor Gas' storage facilities and to update the level of storage available to such customers. Revisions related to the availability and use of storage are discussed further in, and supported by, the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

Q. Why has Nicor Gas proposed to update the administrative and recording charges in Rate 74?

A. In sum, Nicor Gas proposes to update the administrative and recording charges in Rate 74 because our per customer costs have changed since the '95 Rate Case. Our unit costs have changed as a result of both changes in our total costs and changes in the number of customers from which these costs must be recovered.

Q. Please describe the proposed update of the individual and group administrative charges in Rates 74.

A. Nicor Gas proposes to increase the monthly Administrative Charge applicable to individual account transportation customers from $24.00 to $25.00 and to decrease the Administrative Charge charged to group accounts from $14.00 per month per account to

$7.00 per month per account. For group accounts, the minimum monthly Administration Charge would also decrease from $38.00 to $32.00.

Q. Why does the Company not need to make similar revisions in Rates 76 and 77?

A. The costs recovered through the individual Administrative Charge in Rate 74 are recovered through the Customer Charges for Rates 76 and 77. The Company, therefore, increased the proposed Customer Charge provided for in Rates 6 and 7 by $25 (the amount of the Rate 74 Administrative Charge) to arrive at the proposed Customer Charge applicable to companion Rates 76 and 77.

Q. Please describe the rationale for Nicor Gas' proposed update of individual and group administrative charges.

A. The expenses to provide the specific services which are recovered through the Administrative Charge have decreased significantly since the charge was last set in the '95 Rate Case. In total, such expenses have decreased from $2,540,000 to $1,584,000, a decrease of about 40%. For example, the incremental cost for Special Services to print and mail transportation bills, compared to sales bills, has all but been eliminated because Gas Transportation and Billing Services is now able to mail bills more efficiently. Over the same time period, technological and productivity improvements have permitted Gas Transportation and Billing Services to serve customers with fewer people. Similarly, the Meter Reading Department is reading transportation meters with fewer people, again due to technological and productivity improvements.

However, while total costs have decreased, the number of individual accounts and total groups taking end user transportation service has also decreased – there are currently 15,168 accounts (1,518 single accounts and 13,650 group accounts) being served under transportation rates, as compared to 17,953 accounts in 1995. The net result is that the monthly Administrative Charge should increase from $24 to $25 for individual accounts in order to recover the Company's expenses. In effect, the reduction in the number of individual accounts that share administrative costs associated with transportation service requires each account to share a slightly greater burden of the reduced total expense.

With respect to group accounts, the total number of individual accounts in all groups taking transportation service have remained relatively stable since the '95 Rate Case, but the number of groups has dropped from 2,788 to 923, a decrease of 67%. In other words, a decreasing number of groups now include a similar total number of accounts, with the result that a typical group now contains, on average, many more accounts than it had in the past. This has caused the group contract cost to be cut nearly in half. As a result, the required Administrative Charge for group accounts decreases from $14.00 to $7.00, and the minimum group charge decreases from $38.00 to $32.00.[†]

Q. Has the Company prepared an Exhibit showing the derivation of the Administrative Charges as explained in your testimony?

A. Yes. Nicor Gas Exhibit 12.3 consists of workpapers showing the derivation of these charges and demonstrating that the proposed charges appropriately recover the Company's relevant costs.

Q. Please describe the proposed update of the Recording Device Charges in Rate 74.

[†] The purpose of the minimum group charge is to guide suppliers away from setting up groups with only one or two customers, while recovering the Company's costs of such small groups. The rationale supporting the minimum group charge remains unchanged.

A. Nicor Gas proposes to increase the monthly Recording Device Charges from $4.00 to $5.00 for each Rate 74 account with a diaphragm meter. The existing $12.00 monthly Recording Device Charge for each account with any other meter type remains unchanged.

Q. Please describe the rationale for Nicor Gas' proposed update of the Recording Device Charges.

A. Overall, the expenses recovered through the Recording Device Charges have remained relatively unchanged since the '95 Rate Case. Expenses related to rotary instrument meters increased by about $25,000, while expenses related to diaphragm meters decreased by about $28,000. However, the decreasing number of applicable accounts with diaphragm meters has required each such account to assume a larger portion of the expenses related to the monthly recording device charge. Thus, even though expenses related to diaphragm meters decreased by 28%, the 56% drop in accounts with a recording device on a diaphragm meter caused the per meter expense to increase to $5.00. There was no significant change for accounts with a recording device on any other meter type.

Q. Has the Company prepared an Exhibit showing the derivation of the proposed Recording Device Charges as explained in your testimony?

A. Yes. Nicor Gas Exhibit 12.4 consists of workpapers showing the derivation of these charges and demonstrating that the proposed charges appropriately recover the Company's relevant costs.

Q. Are there any riders in which these same charges also appear?

A. Yes. The Administrative Charges and Recording Device Charges should also be updated in Nicor Gas' Rider 25, Firm Transportation Service.

Q. Are there any other charges included in Nicor Gas tariffs that should be updated for reasons similar to those applicable to the Transportation Administrative Charges and the Recording Device Charges?

A. Yes. The Group Change Fee applicable when transportation customers move into or out of a group should be decreased from $30.00 to $15.00. This charge is authorized by Terms and Conditions, at Sheet No. 52 (Nicor Gas Exhibit 12.1, Sheet No. 52). Also, the Non-Common Ownership Group ("NCOG") Fee charged under Rider 13 – Supplier Transportation Service (*id.*, Sheet No. 71) should be reduced from $50 to $35 per month.

Q. Please describe the rationale for Nicor Gas' proposed update of the Group Change Fee.

A. In 1995, when the Group Change Fee was originally priced at $30, it was determined that processing time to add or delete group members was one hour and twenty six minutes. Also, Non-Common Ownership Groups were a newly implemented feature and it was more labor intensive to process adds/drops. Now, some nine years later, efficiencies with contract processing and group management have reduced processing time to 26 minutes. The proposed charge reflects these efficiencies, plus an update of the labor and overhead costs for each employee that plays a role in the processing of a group change.

Q. Has the Company prepared an Exhibit showing the derivation of the proposed Group Change Fee as explained in your testimony?

A. Yes. Nicor Gas Exhibit 12.5 consists of workpapers showing the derivation of this charge and demonstrating that it appropriately recovers the Company's relevant costs.

Q. Please describe the rationale for Nicor Gas' proposed update of the NCOG Fee.

A. When the NCOG Fee was established at $50, it was determined that expenses related to NCOGs would total about $9,700. Those expenses were then divided by 200, the total number of anticipated NCOGs, to arrive at the current NCOG Fee of $50.

Nicor Gas now has actual experience with administering NCOGs. Based on that experience, the total expenses (including overhead costs) related to NCOG management is projected at about $8,000. However, the number of NCOGs has grown to 242, or about 20% more than the number originally estimated. Decreasing the NCOG Fee from $50 to $35 per month will recover the relevant expenses.

Q. Has the Company prepared an Exhibit showing the derivation of the proposed NCOG Fee, as explained in your testimony?

A. Yes. Nicor Gas Exhibit 12.6 consists of workpapers showing the derivation of this charge and demonstrating that it appropriately recovers the Company's relevant costs.

Q. What operational changes has Nicor Gas proposed to transportation rates and riders?

A. The Company has proposed four operational changes to transportation rates and riders.

- A reduction in storage capacity available from 26 Maximum Daily Contract Quantity ("MDCQ") days to 23 MDCQ days. This is consistent with the Company's growing peak day requirement and stable annual withdrawal requirement. The appropriate level of available storage capacity has been determined by dividing Nicor Gas' planned peak day into the annual amount of withdrawal from on-system storage (120 Bcf / 5.258 Bcf). This revision is discussed in further detail in the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

- A reduction in the amount of gas that can be withdrawn from storage on Critical Days and OFO Shortage Days. The Company is proposing to reduce the amount from 2.3% of purchased storage capacity to 2.1%. This conforms with the deliverability from storage that the Company has on a peak day. This value is calculated by dividing the peak day deliveries from storage by the annual volume withdrawn (2.5 Bcf / 120 Bcf). This revision is also discussed in further detail in the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

- The third change reflects the Company's need for transportation customers to more fully cycle their gas in the Company's underground storage facilities. Transportation customers will need to fill the storage capacity that they have selected to 90% or greater by November 1 and will need to reduce their balances to 10% or less by April 1 or their withdrawal and injection rights will be reduced. This revision is also discussed in further detail in the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

- The final change reflects a reduction in the maximum daily nominations by customers during the heating season from two times the customer's MDCQ to one. This change will also encourage the cycling of gas in storage and more closely match how the Company operates the system.

Q. If accepted by the Commission, when should these revisions apply?

A. The planning cycle for our transportation customers normally starts in early spring of each year with their selections going into effect on June 1. The Company believes that it would, therefore, be appropriate to apply the first (23 MDCQ days of storage) and second (2.1% limitation on Critical and OFO Shortage Day withdrawal rights) beginning on the first June 1 after the proposed rates become effective. The remaining changes can and should apply immediately upon the rates becoming effective.

Q. Did the Company consider proposing a special rate classification for gas used in grain drying and other applications with similar annual demand characteristics?

A. Yes. The Company considered proposing such a rate in its initial filing, but considering the recent history of litigation of these rates, wished to discuss this issue with interested parties who may intervene in the case, as well as with the Commission's Staff, prior to selecting a rate design. The Company has no objection to considering such a rate, provided that: (a) it is revenue neutral; (b) appropriately defines a class, by usage characteristics, that imposes significantly different costs on Nicor Gas than other customers in the otherwise applicable rate classification; (c) can be practically implemented and billed, without significant increase in the Company's overall cost of service. To be clear, if such a rate were offered by Nicor Gas, it should apply to end users with defined use characteristics similar to those in other Illinois gas utilities' tariffs (*e.g.*, the customer may use no more than 5% of its total annual therms during the heating season) and should not be defined by the purpose for which the gas is consumed.

<u>Revisions to Rider 6 – Gas Supply Cost</u>

Q. Please summarize the revisions that Nicor Gas proposes to make to costs collected through the Gas Supply Cost mechanism implemented in its Rider 6.

A. Nicor Gas proposes two substantive changes to the costs collected through its GSC mechanism:

- Nicor Gas proposes to credit against purchased gas costs, on a monthly basis, the full amount of net revenue (gross receipts under Rate 21 and our rates on file at FERC, less the cost of Hub operations) that it receives from the operation of the Chicago Hub. This proposal is discussed in more detail in, and is supported by, the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

- Nicor Gas proposes to recover through the GSC mechanism that portion of its total provision for uncollectibles which is attributable to unpaid cost of gas. Uncollectible expense attributable to other services, *e.g.*, distribution, would continue to be included, on a test year basis, in base rates.

Q. Why is it appropriate for Nicor Gas to recover the portion of its uncollectible expenses that is attributable to unpaid gas commodity charges through a rider mechanism?

A. Currently all uncollectible expense is recovered, on a test-year basis, as part of the base rate revenue requirement that is allocated and charged to customers. Moreover, the rate at which the Company can recover uncollectible expense of all types is based upon what was accepted as representative by the Commission in the ’95 Rate Case. However, Nicor Gas’ experience since the ’95 Rate Case has demonstrated that uncollectible expense, in fact, meets the requirements that have historically supported recovery through a rider mechanism such as the Gas Supply Cost mechanism. We also strongly believe, as we will discuss and as discussed by Dr. Gordon (Nicor Gas Exhibit 2.0), that recovery of the portion of our uncollectible expenses that are attributable to gas supply costs through the Gas Supply Cost mechanism is the appropriate rate design and most fair to our customers and the Company.

Q. Why is recovery through the Gas Supply Cost mechanism of that portion of Nicor Gas’ uncollectible expenses attributable to gas supply costs the appropriate rate design and most fair to the Company and its customers?

A. There are several reasons why recovery through the Gas Supply Cost mechanism of that portion of Nicor Gas’ uncollectible expenses attributable to gas supply costs is the appropriate rate design and most fair to the Company and its customers.

First, much of Nicor Gas’ uncollectible cost is beyond any realistic control by the Company. Our analyses show that uncollectible expense is largely a function of gas costs, which for the most part are outside of Nicor Gas’ control, and to a lesser extent, are reflective of the general condition of the economy and availability of government programs, which are completely outside of the Company’s control. When gas commodity costs rise, they not only correspondingly increase the value of the gas supply cost portion of uncollectible expense, but they also make non-payment more likely. Thus, as gas costs have become more volatile and have trended higher, the Company's ability to control its uncollectible expense has been reduced. Similarly, as macro-economic conditions in the service territory change, the risks that customers will be unable or unwilling to pay their gas bill also change. This risk is particularly acute when economic conditions cause customers to terminate service, because customers terminating service are both more likely to leave unpaid bills and less likely to ultimately pay them. It is certainly true that Nicor Gas' credit policies can have some impact on uncollectible expense and we remain committed to managing credit and collection activities effectively. (*See* direct testimony of Ms. Christine Suppes, Nicor Gas Exhibit 7.0). No degree of management, however, can fully offset or control the effect that factors outside of our control have on this type of expense.

Second, the gas supply cost portion of uncollectible expense, in particular, both fluctuates year-to-year and with longer-term exogenous factors, and is not likely to be fairly represented by a single fixed amount included in a test year revenue requirement, regardless of whether a "point estimate" or an average is used. Since the '95 Rate Case, uncollectible expense has risen more than 350%. Moreover, with gas prices becoming more volatile in the short-term and uncertain in the long-term, the trend will also be toward increased unpredictability in uncollectibles. No matter how good the forecast, and no matter whether it is based on one year or many, one thing is certain: the actual uncollectible costs will not match the amount adopted in the test year and built into base rates.

Third, uncollectible expense is significant. In 2003, the total provision for uncollectible expense was $31.650 million (not including a reduction of $1.888 million due to hedging), while write-offs were $36.797 million. The forecast test year provision for uncollectible expense is $30.355 million, with write-offs forecast to amount to $37.200 million. Additional detail concerning uncollectible expenses is provided in the testimony of Ms. Christine Suppes (Nicor Gas Exhibit 7.0). That forecast provision for uncollectible expense amounts to nearly a quarter (22.4%) of the requested test year net operating earnings, and more than a third (approximately 35%) of forecast net operating earnings. However, it is clear that uncollectible expense is no longer a type of expense that a gas utility like Nicor Gas can simply assume will be offset or dampened by random or contrary movements in other cost components.

Finally, Nicor Gas' proposal is fair and reasonable to both the Company and its customers. By passing through the actual amount of uncollectible gas supply costs, both the Company and its customers are assured that these uncollectible expenses will be recovered exactly once, no more and no less. Likewise, procedurally, it is not in our customers' or the Commission's interest to require Nicor Gas to file a full rate case if and when an increase in uncollectible costs threatens it financially, but its rates are otherwise just and reasonable. Nor is it in the interests of Nicor Gas, the Commission, or customers to require a rate case to be filed if uncollectible costs fall. In short, our proposal simply cannot be expected to harm customers. Moreover, Illinois has already made the legal and policy decision that it is fair and reasonable to recover the prudent costs of gas supply through a GSC mechanism. Nicor Gas' proposal does just that.

Q. Why is it appropriate to treat the portion of uncollectible expense attributable to gas supply as a gas supply cost?

A. First and foremost, the portion of the cost of gas supply that Nicor Gas cannot collect is a gas supply cost. It cannot be put more simply. These costs were appropriately allocated to the GSC when they were originally billed and they should remain gas supply costs when unpaid. The fact that they were not recovered the first time they were billed does not convert them into something other than gas supply costs.

Moreover, unless Nicor Gas recovers these amounts through Rider 6, its total GSC recoveries can never equal its total cost of gas. As we understand it, the GSC mechanism is intended to – and does – authorize Nicor Gas not just to bill for, but to recover, its costs of purchased gas. As the Commission observed in 1995: "… Part 525 [the Commission's regulations governing the GSC mechanism] … is the tracking mechanism designed to allow utilities to recover, dollar for dollar, their cost of gas."[†] That is what Nicor Gas' proposal accomplishes.

Q. How does Nicor Gas propose to administer this addition to the GSC expense?

A. Each month, Nicor Gas would multiply its provision for uncollectibles by 66.6% and recover the resulting portion through Rider 6. The recoveries would be reconciled, along with all other GSC costs and recoveries, on an annual basis, and Nicor Gas would provide an auditor's statement, subject to Commission review, that its annual provision is an accurate number. [‡]

[†] *Illinois Commerce Commission on Its Own Motion: Revision of 83 Ill. Adm. Code 525*, ICC Docket No. 94-0403, 1995 Ill. PUC Lexis 579 (Aug. 23, 1995) at 3 (emph. added).

[‡] To be clear, Nicor Gas requests the Commission approve and fix the 66.6% ratio in this Docket; the amounts recovered, not this percentage, would be subject to reconciliation.

Q. How did Nicor Gas determine the 66.6% share of its total provision for uncollectible expense that represents unpaid gas commodity costs?

A. Nicor Gas used a valid statistical sampling methodology to determine, within narrow ranges, the portion of its total uncollectible expense that represents unpaid commodity charges. To do this, the Company randomly sampled charged-off amounts from its residential space heating, residential non-space heating, and non-residential customer pools. To ensure that the sampling methodology used was valid and unbiased, and that the results would, with a 95% level of confidence, be within ± 5%, we retained Dr. Cesar Herrera, a statistician and econometrician expert in the utility industry. Dr. Herrera, whose direct testimony is submitted as Nicor Gas Exhibit 15.0, advised us on the sampling process and confirmed that the process used met the required criteria. We then examined the sample generated by this process, and by individually reviewing each sample account, determined the share that was attributable to unpaid commodity charges. That share was determined to be 66.6%.

Q. In the past, some concern has been expressed that passing uncollectible costs through a rider will eliminate a utility's incentive to effectively control such costs. Is this a concern with Nicor Gas' proposal?

A. No, it should not be a concern. Under Nicor Gas' proposal, a significant portion of the total uncollectible expense will still be included as a test year expense item that Nicor Gas will be able to recover only through fixed base rates. As we testified above, 33.4% of approximately $30.4 million in test year uncollectibles, or some $10.154 million, will be subject to recovery through base rates. This provides a more than adequate incentive for Nicor Gas to take effective action to manage its uncollectible expenses as best it can.

Indeed, if Nicor Gas does not effectively manage its uncollectible expenses, it stands to incur a significant under-recovery.

Q. Are there any other revisions that Nicor Gas proposes to make to Rider 6?

A. Yes, we propose to revise the definitions section of Rider 6 (Nicor Gas Exhibit 12.1, Sheet No. 58) to reflect the replacement of the Aggregator Balancing Service Charge ("ABSC"), which has historically been charged to suppliers, with a Customer Select Balancing Charge to be paid directly by customers ultimately using the balancing service. We will discuss further the rationale for this change in rate design in connection with our discussion of amendments to Rider 15 – Customer Select, later in this testimony.

<u>Revisions to Other Riders</u>

Q. Nicor Gas has proposed changes to Rider 7 – Governmental Agency Compensation Adjustment (Nicor Gas Exhibit 12.1, Sheet Nos. 63 – 63.5). Please describe the proposed changes.

A. Rider 7 currently authorizes the Company to recover from customers taking service within the geographic boundaries of a unit of local government certain charges and fees imposed on Nicor Gas by that unit of local government. The Company proposes to clarify and expand the scope of Rider 7 to include the recovery of all franchise and related costs, including the costs of reduced charge service and incremental construction and maintenance costs, imposed on Nicor Gas by a unit of local government, so that all such costs are recovered solely from customers taking service within the boundaries of that unit of local government, not from all customers in general. The proposed tariff also amends Rider 7 to provide an efficient mechanism by which the charges applicable to customers within individual governmental boundaries can be annually adjusted to take into account changes in the costs imposed, and can be annually reconciled against the prior year's collections.

Q. Why should Rider 7 include the recovery of franchise costs?

A. Nicor Gas has franchise agreements with 478 incorporated municipalities in its service territory. These franchise agreements typically provide for reduced fee gas service or a cash payment based on the population of the municipality and other considerations. However, the costs they impose are not uniform. Nonetheless, the Company currently recovers these costs through its base rates, on a uniform basis. Allowing Nicor Gas to localize the recovery of these costs is more equitable to our customers. It will better match charges with costs by allowing the Company to recover these local costs from the customers using the services provided by the governmental body imposing the costs.

There is precedent for this treatment of costs, especially in northern Illinois. While, at the time of the '95 Rate Case, the Commission's Staff expressed interest in changing the recovery of franchise costs as proposed, there was no concrete proposal made. However, several years later, in 1998, this issue was raised and addressed by the Commission in the context of fees imposed on Commonwealth Edison, and ComEd was allowed to recover such costs, through a rider, from local customers.

Q. Why should Rider 7 include an annual adjustment and reconciliation mechanism, as proposed?

A. Franchise fees and costs, particularly when required to be "paid" in the form of reduced fee service, can vary from year to year. Moreover, the level of collections of such charges are a function of the use by customers within the boundaries of each jurisdiction. By permitting the annual adjustment of the charge authorized by the rider and establishing a mechanism for annual true-up of the collections and costs, both Nicor Gas and our customers are protected against over- or under-recovery, and the costs imposed by units of local government are both fairly and accurately recovered.

Q. Are there any other reasons why Rider 7 should be amended as proposed?

A. Yes. A rider of this type would allow for the Company to be in a position to more flexibly negotiate franchise agreements with units of local government without placing in doubt its ability to recover the resulting franchise costs. This benefits local governments as well as Nicor Gas.

Q. When has Nicor Gas proposed to implement this revision to Rider 7?

A. Nicor Gas proposes that the localization of charges proposed in Rider 7 become effective on January 1, 2007. Due to the extent of the required changes to the Company's billing system and other information systems, this proposal cannot be efficiently implemented prior to this date. Moreover, because the costs the Company proposes to recover through Rider 7 typically are imposed (or, in the case of free service, monetized) on an annual basis, re-allocating these costs on a calendar year basis is most efficient.

Q. Nicor Gas has proposed a clarification to Rider 8 – Adjustments for Municipal and State Utility Taxes. Please describe that change and explain why it is being proposed.

A. Nicor Gas proposes to amend Rider 8 (Nicor Gas Exhibit 12.1, Sheet No. 64) to explicitly reflect the fact that Nicor Gas is collecting municipal gas use tax on behalf of municipalities that can lawfully impose such a tax. This is a housekeeping revision that reflects existing taxes and will not change customers' bills in any way.

Q. Nicor Gas Group Exhibits 12.1 and 12.2 reflect the cancellation of Rider 9, Air Conditioning Service. Please explain Nicor Gas' proposal.

A. New enrollment in Rider 9, (Gas) Air Conditioning Service, which is applicable to Rate 4, General Service and Rate 74, General Transportation Service, was eliminated in the '95 Rate Case and only existing "grandfathered" customers remain on the rider. The Company now proposes to complete the transition away from Rider 9, and to cancel this rider. Any metered gas deliveries to the remaining customers would thereafter be subject to the Company's corresponding standard volumetric charges for the customer's applicable rate classifications.

Q. Why should Rider 9 now be cancelled?

A. Rider 9 should be cancelled at this time for several reasons. Due to changes in the efficiency of electrical equipment and the lack of new technology in natural gas equipment, many Rider 9 customers no longer utilize gas air conditioning equipment. Rider 9 was established to promote the use of gas air conditioning for commercial customers through the implementation of a lower distribution charge. It is no longer effectively serving that purpose. The number of customers on the Rider is low – 143 "active" customers – and many Rider 9 customers no longer fully utilize their gas air conditioning units. Moreover, interest in Rider 9 is sharply declining. In April of 1996, after the '95 Rate Case, there were a total of 283 active Rider 9 accounts. Since that time, 140 Rider 9 customers – approximately half of the grandfathered accounts – have removed themselves from Rider 9. These facts were recognized and anticipated in 1995, when the Company proposed freezing the rider. Cancellation of the rider completes the phase-out of distinct charges for gas used for air conditioning purposes that was commenced with the tariffs filed in the '95 Rate Case.

We also note that, in addition to the 9-year "phase out" afforded by the rider being frozen since 1996, cancellation of Rider 9 will not result in "rate shock." The majority of the 143 active Rider 9 customers who still use gas cooling will experience only a small increase in base rates. Seventy-three of the 143 active Rider 9 customers would experience an increase in base rates of 1% or less, and the average increase would be only about 5.3%, before any proposed increase in other rates. The group would experience an even smaller increase in total gas cost (base rates plus gas commodity costs), averaging only be about 0.5%. Only 23 out of the 143 active Rider 9 customers would experience an increase of more than 1% in their total gas costs.

Q. Nicor Gas Group Exhibits 12.1 and 12.2 also reflect the cancellation of Rider 10, Alternative Fuels Service. Please explain why Rider 10 should be cancelled.

A. Rider 10 was applicable to non-residential rates and was developed to economically retain large commercial and industrial gas customers who had duel-fuel capability and who may from time-to-time, as market pricing permitted, have had the ability to switch to either No. 5 or No. 6 fuel oils. Rider 10 accomplished this by offering a gas supply cost to these customers that was competitive with these fuel oils. Due to a variety of factors, including (i) heightened environmental air quality concerns, (ii) concerns with above ground and underground oil storage tanks, (iii) poor liquidity and the diminishing availability of No. 5 and No. 6 fuel oil supplies, and (iv) destruction of the competitive market for Nos. 5 and 6 fuel oils in the Midwest region, there has for years been little to no customer demand for this service. Currently there are no customers subscribing to service under Rider 10 and there is no anticipated demand for the service in the future. As a result, the cancellation of this rider will have no customer impact.

Q. Nicor Gas Group Exhibits 12.1 and 12.2 reflect amendments to Rider 12, Environmental Cost Recovery, in addition to the deletion of references to rates that the Company proposes to cancel. Please explain such amendments.

A. Nicor Gas proposes to revise Rider 12 (Nicor Gas Exhibit 12.1, Sheet No. 68) to make clear that research and development costs associated with environmental remediation and other costs imposed by reason of the past manufactured gas operations are included in costs recoverable under Rider 12. Such costs are part of the current costs of addressing prior manufactured gas operations which the rider is intended to recover. Their recovery through Rider 12 is consistent with Rider 12's purpose, and with the scope of similar riders on file for other utilities. Also, the language concerning research and development is intended to address an issue raised in a recent reconciliation proceeding concerning whether or not money spent on researching particular methods for effectively remediating a site was an Environmental Activity as defined in Rider 12.

Nicor Gas also proposes to change the interest rate used for both refunds and over-collections from the after-tax cost of capital to the deposit rate established annually by the Commission and used in the Gas Supply Cost calculations. This change is consistent with the Commission's current decision to recover applicable costs under the rider over a one-year period. This amendment appears on Sheet 70 of Nicor Gas Exhibit 12.1.

Q. Why should the interest rate be changed to the deposit interest rate established annually by the Commission?

A. The interest rate for Rider 12 was determined in the original Coal Tar expense proceeding, ICC Docket Nos. 91-0080 to 91-0095 (Consolidated). In that proceeding, Nicor Gas argued that if costs were to be recovered over a period of years, as approved by the original Order, then the appropriate interest would be the after-tax cost of capital as established in a utility's last rate case. However, the Company argued, if costs were to be recovered over a one year period, then the appropriate interest rate would be the short-term rate used in PGA filings. In supporting and adopting the after-tax cost of capital as the rate to be used, the Commission cited as one reason the nature and duration of the delay between expenditure and recovery.[†]

However, the Commission's order in the Coal Tar proceeding was appealed by other parties, and the Commission subsequently issued an Order on Remand in which it reversed the original decision to recover applicable costs over a five-year period and instead instituted recovery on a one-year basis. Additionally, under the original order, utilities were not allowed to recover carrying costs, but were allowed by the Order on Remand to recover carrying costs. However, the Order on Remand did not change the use of the after-tax cost of capital as the appropriate interest rate to calculate carrying costs. Given that applicable expenses are recovered annually, Nicor Gas believes that the interest rate should also reflect the annual cost of money.

Q. Nicor Gas Exhibits 12.1 and 12.2 reflect amendments to Rider 13, Supplier Transportation Service, in addition to the deletion of references to Rate 81, which the

[†] *Illinois Commerce Commission on Its Own Motion: Investigation concerning issues related to coal tar cleanup expenditures*, ICC Docket Nos. 91-0080 – 0095 (Consol.), 1992 Ill. PUC Lexis 379; 137 P.U.R.4th 272 (Sept. 30, 1992) at 188-189.

Company proposes to cancel, and the revision of the Group Charge you have previously discussed. Please explain these amendments.

A. Nicor Gas proposes housekeeping revisions to the Availability section of this rider (Nicor Gas Exhibit 12.1, Sheet No. 71) to eliminate language applicable only to the rider's initial implementation.

Nicor Gas (*id.*, Sheet No. 72) also proposes revisions, similar to those proposed for Rates 74, 76, and 77, to update the level of storage capacity available to Customer Select suppliers. These revisions are discussed further in, and supported by, the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

Q. Nicor Gas Group Exhibits 12.1 and 12.2 reflect amendments to Rider 15, Customer Select. What is the first amendment Nicor Gas proposes?

A. Nicor Gas proposes to revise the availability provisions of Rider 15, Customer Select (Nicor Gas Exhibit 12.1, Sheet No. 75.1) to delete the obsolete reference to the Customer Select Pilot Program and to consistently reflect the agency nature of the relationship between the customer and the Customer Select supplier.

Q. Nicor Gas also proposes to impose a Customer Select Balancing Charge on Rider 15 customers. Please explain what this charge is and why its should be approved.

A. Nicor Gas incurs costs in connection with procuring gas to balance our system. For sales customers, this cost is collected as part of the cost of gas under Rider 6. Currently, however, for customers taking service under Rider 15, these costs are aggregated, in the form of the Aggregator Balancing Service Charge, and collected from Customer Select suppliers rather than directly from customers. We previously mentioned this charge in discussing proposed revisions to the definition contained in Rider 6. The ABSC is calculated on a per therm basis, and fluctuates monthly.

Recovering balancing costs from suppliers on an aggregated basis was originally intended to assist customers in comparing Nicor Gas' gas cost with an offer from another supplier by allowing balancing costs to be included in each supplier's charges. However, that rate design has not worked as intended and, in fact, has been an issue with suppliers and customers alike since Customer Select's inception. Instead, the practice that has developed is for suppliers to pass this cost onto their customers as a separate line item on their bill, rather than including it in the supplier's cost of gas. Indeed, because the ABSC changes monthly, it would be difficult for a supplier to build the ABSC into its gas price if the supplier is offering a fixed price product.

Suppliers have also informed us that it is costly and time consuming for them to handle customer inquiries about this charge. Indeed, one of our largest Customer Select suppliers claims that the ABSC charge is their biggest source of customer complaints. Customers frequently do not accept the supplier's explanation of the charge. Because the ABSC does not appear to customers to be imposed directly by Nicor Gas, they also frequently contact the Company's customer service center to pursue the issue further. This, in turn, increases the Company's costs and contributes to customer confusion. Moreover, that confusion can be compounded when the name for this charge used by the Customer Select supplier is not the same as, or does not refer to, Nicor Gas' ABSC. This may make customers feel that they have been deceived when, in reality, they have not.

The proposed amendment resolves these issues on a revenue-neutral basis and with no change in the inter-class division of these charges between sales and Customer

Select customers. The amendment to Rider 6, discussed above, creates a new Customer Select Balancing Charge ("CSBC") in lieu of the ABSC. The balancing charges attributable to sales customers continue to be passed through Rider 6, as before. However, customers participating in the Customer Select program under Rider 15 will now be charged directly for their share of Nicor Gas' balancing expense through the CSBC instead of indirectly through their suppliers' charges. The amendment to Rider 15 required to implement this change appears on Sheet 75.1 of Nicor Gas Exhibit 12.1. The corresponding amendment to Rider 16 – Supplier Aggregation Service to delete the reference to the ABSC appears on Sheet 75.4 of Nicor Gas Exhibit 12.1.

Q. Does Nicor Gas propose any other amendment to Rider 15?

A. Yes. The Company proposes to amend Rider 15 (Nicor Gas Exhibit 12.1, Sheet No. 75.2) to remove the reference to include the Customer Select suppliers charges in payment arrangements made between the Company and the customer. No supplier has utilized this payment arrangement provision, and having Nicor Gas' customer service representatives negotiating with both the customer and the Customer Select supplier would increase costs and customer confusion.

Q. Nicor Gas Group Exhibits 12.1 and 12.2 also reflect amendments to Rider 16, Supplier Aggregation Service other than the deletion of the reference to the ABSC that you testified about above. Please identify and explain these amendments.

A. As with several of the other tariffs we have discussed, Nicor Gas proposes to update the level of storage available to Customer Select Groups. These revisions are reflected on Sheet No. 75.7 of Nicor Gas Exhibit 12.1 and are discussed further in, and supported by, the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

The Company also proposes (Nicor Gas Exhibit 12.1, Sheet No. 75.6) to update the amount of firm supply that a supplier must have available for delivery to our city gate on a Critical Day from 32% to 34% of the Group's current MDCQ to conform to the Company's peak day supply needs. In addition, the Company is expanding from 2% to 5% the tolerance level applicable at the end of the month to the variation between required deliveries for the month and actual deliveries nominated by the supplier. This last amendment is implemented at Sheet 75.5 of Nicor Gas Exhibit 12.1 and is also discussed in the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0).

Other Revisions to Terms & Conditions

Q. Nicor Gas has also proposed a number of revisions to its Terms and Conditions that do not relate to specific rate classifications or riders. Please describe the first such revision.

A. Nicor Gas proposes to clarify its definition of "Customer" (Nicor Gas Exhibit 12.1, Sheet No. 33) to make clear that a customer who is taking service from Nicor Gas is "a person or persons receiving service under a Residential Service rate … or a single entity receiving service on a single premises under a non-residential service rate subject to the 'Redistribution of Gas' provision."

The proposed language also addresses the growing practice of end users dealing with the Company through a variety of agents. The proposed language makes clear that, except for credit and collection activity and disconnection of service, these agents are also to be deemed customers of Nicor Gas when they are acting as, and authorized by the customer to act as, the customer's agent. This will enable the authorized agent to exercise options and take other actions with respect to the customer's service, as well as protecting Nicor Gas, who is not a party to the agreement between the customer and agent, from the risks of relying on the agent's instructions. However, Nicor Gas recognizes the special risks attendant with disconnection, and has, therefore, proposed that agents not be permitted to function as a customer for the purposes of disconnection. Disconnection notices will continue to go to the end user's address on file with Nicor Gas.

Q. Nicor Gas has proposed to change its Terms and Conditions with respect to customer damage to distribution pipe. Please describe the proposed change.

A. The Company proposes to increase the charges for damage to the Company's non-steel pipes with a diameter of 1-1/8 inches or less. This change is reflected on Sheet No. 35 of Nicor Gas Exhibit 12.1. This increase is reflective of the increased costs since the '95 Rate Case of repairing such facilities.

Q. Why should the Company's proposal addressing customer damage to distribution pipe be approved?

A. The Company recently reassessed the weighted average cost for repairing service pipe with a diameter of 1-1/8 inches or less, using current costs for labor, escaping gas, transportation, and materials and supplies. While some cost components, *e.g.*, transportation and material and supplies, decreased since the charge was last calculated, that decrease is more than offset by increased labor costs and the higher costs of escaped natural gas. These updated costs are reflected in the proposed charge.

Q. Nicor Gas has proposed to change its Terms and Conditions with respect to charges imposed for returned negotiable instruments. Please describe the proposed change.

A. The Company proposes to increase from $10.00 to $16.00 based upon Nicor Gas' own costs and the charge on the Company imposed if a check or other negotiable instrument is dishonored and returned on account of there being insufficient funds, the account being closed, or other reasons where there has been no error by either the Company or the customer's financial institution. This change is reflected on Sheet 39 of Nicor Gas Exhibit 12.1.

Q. Why should the Company's proposal with respect to charges imposed for returned negotiable instruments be approved?

A. The existing charge has been in force for some time and no longer recovers even the Company's direct costs. Based upon a survey of direct costs of the Company and costs charged to the Company by its financial institution, the cost of a returned item is at least $16.24. This cost, moreover, is rising and is expected to continue to rise throughout the period that the proposed rates will be in effect.

Q. Nicor Gas has proposed to change its Terms and Conditions with respect to Budget Payment Plans. Please describe this proposed change and explain why it should be approved.

A. The Company proposes (Nicor Gas Exhibit 12.1, Sheet No. 39.5) to eliminate the requirement that it review each budget payment amount on a quarterly basis. This proposal gives the Company flexibility to change the review period as needed. For example, it permits the Company to use a longer review period during low-cost or low-use periods, where a more frequent reassessment is not required. Moreover, automatic revision on a quarterly basis resulted, in many cases, in fluctuations greater than desired by the customer. The adjustments were perceived as being too frequent, so that, in simple terms, it was not really a budget from the customer's perspective. A longer period, where appropriate, can provide greater smoothing. However, there are times – for example where service characteristics or credit exposure change – where revision on a basis more frequent than quarterly is appropriate. The proposed tariff recognizes and accommodates this as well.

Q. The Company also proposes to update the charges for certain gas service pipe installations. Please describe this proposal and why it should be approved.

A. The Company's Terms and Conditions (Nicor Gas Exhibit 12.1, Sheet No. 41) provide, in certain circumstances, for standard per foot charges for the installation of additional service pipe (line extensions) required on a customer's premises. These charges have not been reset since the '95 Rate Case. Prior to filing this case, the cost for installing excess footage for service pipe was re-determined using current costs for labor, transportation, and materials and supplies. While the cost for transportation and for materials and supplies has decreased over the years, this decrease is more than offset by increased labor costs. The proposed unit charges for excess footage are derived from the updated costs for labor, transportation, and materials and supplies.

Q. At Sheet No. 52.5, Nicor Gas Exhibit 12.1 reflects a proposed amendment to Terms and Conditions dealing with telecommunication outages. Please explain this amendment and why it should be approved.

A. The amendment makes meaningful the consequences of repeated or prolonged telecommunications outages, while ensuring that such a circumstance does not put an unreasonable burden on the Company and drain resources used to serve other customers. It makes clear that if it is necessary to remove a customer from a transportation rate that requires daily meter readings due to such repeated or prolonged failures, the customer cannot return to such rates for one year. This is a reasonable period considering the importance of uninterrupted communications for rates requiring daily meter reading, and the deterrent purpose of the provision.

Q. At Sheet 52.5, Nicor Gas Exhibit 12.1 reflects a proposed amendment to Terms and Conditions dealing with storage balance transfers. Please explain these amendments and why it should be approved.

A. Nicor Gas proposes to reduce the charge applicable to excess storage balance transfers from $30.00 to $15.00. This reduction reflects a reduction in our costs. A worksheet showing the derivation of this amended cost is attached hereto as Nicor Gas Exhibit 12.7. The Company has also proposed housekeeping revisions relating to transfers of Storage Banking Service and Firm Backup Service.

Q. Are there any other revisions to Nicor Gas' tariff sheets that you have not yet discussed?

A. Yes. We have proposed a housekeeping revision to Sheet No. 44 to eliminate an obsolete reference to Rate 24 of ILL. C.C. No. 13, a long-cancelled tariff (Nicor Gas Exhibit 12.1, Sheet No. 44). Also, as we have testified before, there are revisions relating to storage explained and supported by the testimony of Mr. Bartlett (Nicor Gas Exhibit 8.0). Finally, Nicor Gas has filed a revised Table of Contents for ILL. C.C. No. 16, Sheet No. 1, that reflects all of the tariff changes that the Company proposes.

Q. Does this complete your direct testimony?

A. Yes, it does.