

Contested Cost of Capital Issues and their Effect on Rate of Return

Cost of Equity Effects:	<u>Basis Point Reduction in Rate of Return</u>	<u>Annual Reduction in Revenue Requirements⁽¹⁾</u>	
Choice of Gas Sample	25	\$6.1	
Growth Rate	15	\$3.6	
McNally 23 bp Risk Adjustment	14	\$3.4	
Other	<u>16</u>	<u>\$3.9</u>	
Total	70	\$17.0	MM/year
Short-term Debt Effects:			
Cost of Short-term Debt	21	\$5.1	
Magnitude of Short-term Debt	<u>57</u>	<u>\$13.8</u>	
Total	78	\$18.9	MM/year
Grand Total Cost of Capital Effects:⁽²⁾	148	\$35.9	MM/year

⁽¹⁾ Based on Nicor Gas' proposed net utility rate base of \$1,441,082,000 and the gross revenue conversion factor of 1.683178.

⁽²⁾ Nicor Gas's requested rate of return of 9.03% - Staff's proposed 7.55% ROR = 1.48% or 148 bps

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Nicor Gas' Proposed Capital Structure & ROR

(\$ in 000's)	12/31/05 Forecasted Actual Capital Structure	Percent	Cost of Capital %	Weighted Cost
Long-term Debt	\$ 500,376	43.51	6.72	2.92 %
Non-redeemable Preferred Stock	1,401	0.12	4.77	0.01 %
Common Equity	648,156	56.37	10.82	6.10 %
	\$ 1,149,933	100.00	10.76	9.03 % ROR

Illustration of Staff's Capital Structure & ROR - Excluding Short-term Debt

Short-term Debt Inclusion	(\$ in 000's)	Staff's Adjusted ⁽¹⁾ Capital Structure	Percent	Cost of Capital %	Weighted Cost
No	Short-term Debt	\$ -	0.00%	2.58	- %
	Long-term Debt	\$ 478,311	42.58%	6.72	2.86 %
	Preferred Stock	\$ 1,386	0.12%	4.77	0.01 %
	Common Equity	\$ 643,607	57.30%	9.54	5.47 %
		\$ 1,123,304	100.00%		8.33 % ROR

⁽¹⁾ Simplified illustration of Staff's proposed capital structure excluding short-term debt. For the simplified purpose of this illustration, it does not alter Staff's proposed \$7,939,227 of AFUDC adjustments or its non-book value weighted approach.

Staff's Proposed Capital Structure & ROR

Short-term Debt Inclusion	(\$ in 000's)	Staff's Proposed Capital Structure	Percent	Cost of Capital %	Weighted Cost
Yes	Short-term Debt	\$ 177,608	13.65%	2.58	0.35 %
	Long-term Debt	\$ 478,311	36.77%	6.72	2.47 %
	Preferred Stock	\$ 1,386	0.11%	4.77	0.01 %
	Common Equity	\$ 643,607	49.47%	9.54	4.72 %
		\$ 1,300,913	100.00%		7.55 % ROR

A	Staff's Cost of Equity Effect:	
	Staff's ROR excluding short-term debt as illustrated above.	8.33 % ROR
	Change in ROR due to Staff's cost of equity (9.03% - 8.33% = .70%)	(70) bps
	Change in net operating income @ Nicor Gas' rate base of \$1,441,082,000	(\$10.1) MM/yr
	Change in annual revenue requirements @1.683178 gross revenue conversion factor.	(\$17.0) MM/yr
B	Staff's Short-term Debt Effect	
	Staff's proposed ROR as illustrated above:	7.55 % ROR
	Change in ROR due to inclusion of short-term debt (8.33% - 7.55% = .78%)	(78) bps
	Change in net operating income @ Nicor Gas' rate base of \$1,441,082,000	(\$11.2) MM/yr
	Change in annual revenue requirements @1.683178 gross revenue conversion factor.	(\$18.9) MM/yr
	Total Reduction in ROR due to Staff's Cost of Equity and Short-term Debt Effects (9.03% - 7.55%)	(148) bps
	Total Reduction in Net Operating Income:	(\$21.3) MM/yr
	Total Reduction in Annual Revenue Requirements @1.683178 gross revenue conversion factor.	(\$35.9) MM/yr

Alternative Cost of Capital IllustrationUtility: Northern Illinois Gas Company
d/b/a Nicor Gas Company

Test Year: 12 Months Ended 12/31/05

Line No.	Class of Capital (A)	December 31, 2005				
		Amount ⁽¹⁾ (\$000) (B)	Percent of Total (C)	Percent Cost (D)	Cost Reference (E)	Weighted Cost (F) = (C X D)
1	Short-term Debt	\$ 36,625	3.11 %	4.12 %	D-2	0.13 %
2	Long-term Debt ⁽³⁾	496,921	42.16	6.72	D-3	2.83
3	Non-redeemable Preferred Stock	1,391	0.12	4.77	D-4	0.01
4	Common Equity	<u>643,681</u>	<u>54.61</u>	10.82 ⁽²⁾	D-6	<u>5.91</u>
5	Total Capital	\$ <u>1,178,619</u>	<u>100.00 %</u>			<u>8.88 %</u>

6 ⁽¹⁾ 2005 Forecasted year-end capital structure including hypothetical short-term debt allocation shown below:Revised Schedule B-1

Gas in Storage	\$ 125,320
Customer Deposits	(23,711)
Budget Plan Balances	(60,965)
Customer Advances for Construction	<u>(4,019)</u>
	\$ 36,625

7 ⁽²⁾ Revised cost of common equity requested in this filing.8 ⁽³⁾ Including redeemable preferred stock and long-term debt due within one year.

Line No.	Class of Capital (A)	December 31, 2005				
		Amount ⁽¹⁾ (\$000) (B)	Percent of Total (C)	Percent Cost (D)	Cost Reference (E)	Weighted Cost (F) = (C X D)
9	Short-term Debt	\$ 28,006	2.39 %	4.12 %	D-2	0.10 %
10	Long-term Debt ⁽³⁾	496,921	42.47	6.72	D-3	2.85
11	Non-redeemable Preferred Stock	1,391	0.12	4.77	D-4	0.01
12	Common Equity	<u>643,681</u>	<u>55.02</u>	10.82 ⁽²⁾	D-6	<u>5.95</u>
13	Total Capital	\$ <u>1,170,000</u>	<u>100.00 %</u>			<u>8.91 %</u>

14 ⁽¹⁾ 2005 Forecasted year-end capital structure including hypothetical short-term debt allocation.Schedule B-1

Gas in Storage	\$ 116,701
Customer Deposits	(23,711)
Budget Plan Balances	(60,965)
Customer Advances for Construction	<u>(4,019)</u>
	\$ 28,006

15 ⁽²⁾ Revised cost of common equity requested in this filing.16 ⁽³⁾ Including redeemable preferred stock and long-term debt due within one year.