

**Docket No.:** 04-0779  
**Bench Date:** 11/2/05  
**Deadline:** 11/7/05

**MEMORANDUM**

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**TO:** The Commission

**FROM:** Thomas G. Aridas, Chief Administrative Law Judge  
Ian Brodsky, Administrative Law Judge

**DATE:** October 27, 2005

**SUBJECT:** Northern Illinois Gas Company d/b/a Nicor Gas Company

Proposed general increase in natural gas rates. (Tariffs filed on November 4, 2004.)

Application for Rehearing, filed by Nicor.

**RECOMMENDATION:** Grant in part and deny in part, as listed in the Overview.

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**Overview**

This Application for Rehearing was filed pursuant to the Orders entered September 20, 2005, and September 28, 2005. Nicor raises these twenty-two issues:

<u>Issue</u>	<u>ALJs' Recommendation</u>
1. Uncollectibles Expense Computation	Grant.
2. Year-End or Average Rate Base Methodology	No recommendation.
3. Pension Asset	Deny.
4. Office Supplies Expense	Deny.
5. Incentive Compensation Expense	Deny.
6. Stock Options Expense	Deny.
7. Rate of Return Adjustment	Deny.
8. Flotation Costs	Deny.
9. Rider 6: Recovery of the Commodity Portion of Uncollectibles	Deny.
10. Rate 1 and Total Therms	Grant in part and deny in part.
11. Daily Metering Project	Deny.
12. Utility Plant Balance	Deny.
13. Budget Payment Plan	Deny.
14. Customer Deposits	Deny.
15. Storage Gas Losses (2% Withdrawal Factor)	Deny.
16. Corporate Benefit Plan Expense	Deny.
17. Payroll Expense	Deny.

18. Storage Capacity Allocation	Deny.
19. Maximum Daily Nomination	Deny.
20. Cycling	Deny.
21. Rates 7 and 77	Grant.
22. Daily Delivery Algorithm	Deny.

Issues are presented first according to our recommendation, then by the sequence in which they appeared in the Order issued September 20, 2005. A recommendation that rehearing be granted does not imply anything about the ultimate disposition of the issue.

### **1. Uncollectibles Expense Computation**

Nicor raised this issue as a computational correction after the Commission entered the Order on September 20, 2005. Its motion to implement this correction drew objections from other interested parties, and therefore was denied (See Notice of Commission Action, Sep. 30, 2005). Rehearing now should be granted to resolve the issue.

*Proposed issue for rehearing: Is an update to uncollectibles expense warranted to reflect changes attributable to base rate charges?*

### **21. Rates 7 and 77**

Nicor seeks a clarification that the Rate 77 demand charge should not include the SBS costs included in Rate 7. The Company states that this change is needed to fully effectuate the companion rate structure between Rates 7 and 77, and is similar to what was approved in Rates 4/74 and Rates 6/76. Rehearing should be granted to clarify this issue.

*Proposed issue for rehearing: Is it appropriate to add to the discussion of Rates 7 and 77 a statement to the effect that "storage costs included in the Rate 7 distribution charge should be removed to obtain the Rate 77 charge, which excludes storage costs through the SBS charge" or alternatively, a statement reaching a different result?*

### **10. Rate 1 and Total Therms**

Nicor alleges that the adjustment proposed by the AG and adopted in the Order used forecast 2004 data rather than actual 2004 data, and that a material difference results. (Application for Rehearing, 18.) Rehearing should be granted on this point, including the amount of the adjustment.

Nicor also includes in the issue the total number of therms and its proposed Rate 4 offset, as set forth in its Emergency Motion Regarding Compliance Tariffs. (Application for Rehearing, 21.) The ALJs separately recommend entry of the Clarification Order granting that Motion. While we note that the total therm/Rate 4 aspect of this issue will become moot if the Commission enters the Clarification Order

and if no change to Rate 1 is adopted, we recommend at this time that rehearing be granted concerning Rate 4/total therms to accommodate other possible outcomes.

Nicor also seeks rehearing on the rejection of its original forecast that Rate 1 sales will decline by 17,937,000 therms in the test year. That position was rejected on the merits; the AG sufficiently demonstrated that this position is inconsistent with other Nicor assumptions or forecasts. Although Nicor continues to disagree with the Commission on the interpretation of the evidence, the Company fails to state a reason to rehear this aspect of the issue.

*Proposed issue for rehearing: Is an adjustment warranted to reflect an application of the AG's methodology with actual 2004 data? If so, what is the proper number of therms attributable to Rate 1 after application of the AG's methodology, and what is the proper number of therms now attributable to the other rate classes as a result of the Rate 1 adjustment?*

## **2. Year-End or Average Rate Base Methodology**

Nicor states that the Order “determined that ‘[i]n light of the forward looking test year selected by the Company’ an average rate base methodology should be adopted, and the Order approved Staff’s calculation of this adjustment as warranting a subtraction of \$40,069,000 from rate base.” (Application for Rehearing, 7.) Nicor offers five arguments why the Order should be amended to reflect the findings in the Proposed Order, the strongest of which is that the average rate base methodology allegedly will deny Nicor recovery of \$17.5 million of net plant, and indirectly deny another \$22.5 million.

*Granting rehearing on this issue would restore the conclusion finding in favor of year-end rate base methodology.*

## **12. Utility Plant Balance**

Nicor dislikes the conclusion reached by the Commission after reviewing all of the evidence on this issue. Its Application for Rehearing recycles several of the citations previously presented in briefs and exceptions. These arguments and evidence already have been fully considered. The Application itself presents no other question for rehearing on this issue, and so it should be denied.

## **11. Daily Metering Project**

Nicor reiterates its exception to the disallowance from rate base of the portion of the daily metering project for which expense was incurred in violation of its own budgeting policy. The Order finds that the policy helps to ensure the reasonableness and prudence of the expenditures. Nicor, citing 220 ILCS 5/9-211, argues that it is entitled to recover the entire reasonable cost of used and useful rate base that was prudently incurred. Nicor’s interpretation of the statute is overly broad. The statute states:

The Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.

We do not read the statute to suggest that all plant that is used and useful must be included in rate base. Instead, by using the form *shall include only*, Section 9-211 excludes from rate base all things other than that plant which is "prudently incurred and used and useful in providing service..." In other words, Section 9-211 imposes a general limit on what qualifies as rate base, but does not prevent the Commission from making further disallowances to reach the just and reasonable rates mandated by Section 9-201. Since the error asserted by Nicor itself lacks merit, rehearing on this point should be denied.

### **3. Pension Asset**

The Commission's Order rejects inclusion in rate base of Nicor Gas' net pension asset and it also requires Nicor Gas to include the \$3,486,000 annual pension credit as a credit against operating expenses in the revenue requirement. Nicor's primary argument on rehearing is that the Commission erred in its finding that the pension asset was created by ratepayer-supplied funds rather than shareholder-supplied funds. According to Nicor, the net pension asset reflects contributions made by Nicor Gas to a pension trust in compliance with its obligations under its pension plan. Nicor also contends the Order provides very little rationale for imposing the accrual of negative pension expense as a credit against operating expenses when calculating the revenue requirement. In short, Nicor does not believe the pension credit should be used to reduce recovery of its operating expenses.

The Commission concluded that Nicor failed to justify its inclusion of the pension asset into its proposed rate base. The Commission based its finding on its own precedent, citing Nicor's last general rate case in 1995 which also found that the overfunded pension asset was created from ratepayer supplied funds. Despite acknowledging the Commission's finding in the 1995 rate case, Nicor, nevertheless, argued in the instant rate case that "approval of recovery" was warranted. The record remains devoid of any new factual information that would warrant different treatment of the pension asset this time around. As a result, we recommend that rehearing on this particular issue be denied.

### **13. Budget Payment Plan**

Nicor seeks a reversal of the issue, which concerned a difference of methodology between Nicor and the AG. Nicor was found not to have met its burden of proof, and therefore its position was rejected. The Application for Rehearing does not appear to present a question other than that which was already presented in its brief on exceptions and implicitly rejected. Rehearing of this point therefore should be denied.

#### **14. Customer Deposits**

Nicor, Staff, and the AG originally proposed various methodology for customer deposits, each of which produced a different result. Staff subsequently withdrew its position, choosing instead to endorse the AG's position. The Order accepts the AG's position. In its Application for Rehearing, Nicor seeks to apply Staff's methodology to adjust the result.

In essence, Nicor is trying to opt in to a position that was dropped prior to trial. It is not clear why rehearing should be granted in this circumstance. Nicor chose its position and litigated it to completion. Furthermore, the Application for Rehearing does not state a reason to open rehearing on the issue. Nicor discusses various figures, but does not explicitly identify any error that should be corrected. Rehearing therefore should be denied.

#### **4. Office Supplies Expense**

Nicor complains about the adjustment to its office supplies expense. The adjustment was implemented, pursuant to Section 9-201 of the Act, because Nicor did not provide sufficient evidence to support its own request. Nicor relies on statements concerning its budgeted figure for office supplies expense, assertions that it now faces greater expenses within this category, and its own assessment that Nicor is an efficient utility. The record lacks supporting documentation, however, including but not limited to workpapers supporting the relevant portion of the budget or documentation of the various expanded costs. The Application for Rehearing essentially repeats Nicor's position, but does not cite evidence that should be considered. Nicor therefore has not stated a reason for which rehearing should be granted.

#### **15. Storage Gas Losses (2% Withdrawal Factor)**

At issue is the method via which Nicor can recover expenses associated with the "2% withdrawal factor" associated with storage losses on third-party gas. The Order found that Nicor should cease its long-standing practice of recovering storage gas losses through Rider 6. Nicor now asks the Commission to reconsider that decision on rehearing. The Commission's finding was based on the fact that Nicor's practice is in direct violation of Ill. Adm. Code Part 505, which sets forth the Uniform System of Accounts for Gas Utilities. Specifically, Account 823 classifies gas losses as an operating and maintenance expense more appropriately recovered through base rates. Since Nicor has failed to sufficiently explain how its practice of recovery through Rider 6 is not in conflict with the aforementioned Commission rule, rehearing on this issue should be denied.

#### **16. Corporate Benefit Plan Expense**

Nicor asks the Commission to reconsider its decision to reduce Nicor Gas' expenses of the administration of its corporate benefit plans by \$1,103,000. The Order adopted AG witness Efron's proposed disallowance based on the fact that the record indicates that in the five years preceding the test year, the payout ration never reached

100%. In fact, the average for that five year period was approximately 50%. Nicor's argument on rehearing does not shed any new light on the issue. Rehearing, therefore, should be denied.

#### **5-6. Incentive Compensation Expense, Stock Options Expense**

In both of these sections, Nicor continues to repeat the same unconvincing arguments. Nothing provided by Nicor suggests that rehearing is warranted; its arguments here are unresponsive to the majority of the determinations in the Order.

Nicor continues to argue that it should be awarded ratepayer funding for its incentive compensation and stock options programs, because they are a portion of Nicor's total compensation package needed to retain a competent work force. This assertion is largely contradicted by Nicor's 55% average payout rate—in other words, that Nicor and its shareholders simply absorb an average of 45% of the incentive compensation expense funded in rates. In addition, Nicor's testimony about total compensation at the median level for the industry fails to address "the specific dollar savings or other tangible benefits" in order to meet its burden of proof. The Order notes that Nicor (1) has a duty to provide safe, adequate, reliable service; (2) bases its incentive compensation largely on the achievement of financial goals; and (3) fails to quantify the benefit that it alleges accrues to ratepayers. Nicor's arguments regarding stock option expense rely on the same arguments, and similarly fail to demonstrate "specific dollar savings or other tangible benefits."

Nicor's argument that the Order states that incentive compensation was disallowed in the 1995 rate case simply is based on a misreading of the Order, which states:

In Nicor's last rate case, the Commission denied recovery of incentive compensation *related to "cost containment, safety, reliability, and customer satisfaction goals" because Nicor did not establish that those goals were met.* (95-0219 at 27.)

(Order (Sep. 20, 2005) at 46 (emphasis added).) Furthermore, the discussion of the payout rate (annual measurements of incentive compensation paid to employees divided by total ratepayer funding of incentive compensation expense) would be irrelevant or impossible had incentive compensation been completely denied in 95-0219.

#### **17. Payroll Expense**

Nicor complains that its payroll expense was reduced. Nicor's witness Bacidore stated that it would hire 50 people in the test year. This assertion was found to be either speculative or not credible given that Nicor failed to introduce even one document related to the planning, announcement, or hiring for the 50 new positions. The Application for Rehearing on this point is not responsive to the Order, and should be denied.

## **7. Rate of Return Adjustment**

Nicor continues to take issue with the Final Order's adoption of Staff's recommended 23-basis-point downward adjustment to the 10.82% return on equity (ROE). Nicor presents the same arguments previously presented in briefs and exceptions. The Final Order clearly explains the many reasons why the downward adjustment is necessary in this instance. As a result, Nicor's Application for Rehearing on this issue should be denied.

## **8. Flotation Costs**

Nicor complains about the conclusion reached by the Commission after reviewing all of the evidence on this issue. Its Application for Rehearing recycles the same arguments previously presented in briefs and exceptions. These arguments and the evidence already have been fully considered. The Application itself presents no other question for rehearing on this issue, and so it should be denied.

## **9. Rider 6: Recovery of the Commodity Portion of Uncollectibles**

Nicor asks the Commission to reverse its conclusion in the Final Order and allow Nicor to recover commodity-related uncollectibles expenses via Rider 6. According to Nicor, the evidentiary record demonstrates that these expenses plainly meet all of the criteria for recovery through a rider. The primary criterion Nicor points to for support of its assertion is the volatility of these expenses.

The Final Order concluded that these expenses are best recovered from base rates and rationalized that the uncollectibles associated with these expenses are a normal cost of the provision of service which do not warrant special recovery through a rider. Furthermore, it is unclear that Nicor's proposal would fully comply with Part 525 Rules. Nicor has failed to sufficiently explain its assertion that the Commission has somehow misapplied the law concerning the nature of charges subject to collection through riders. The Application for Rehearing as it relates to this issue should, therefore, be denied.

## **18. Storage Capacity Allocation**

Nicor asserts that the determination to use 149.74 Bcf, resulting in a maximum storage allocation of 28x MDCQ, is inappropriate for the storage capacity allocation issue.

Nicor makes two assertions in its Application for Rehearing. "First, as the Order recognizes, there is no good reason to depart from the methodology previously approved by the Commission." (Application for Rehearing at 26, no citation provided.) That is an incorrect characterization of the Order. In deciding the issue, the closest statement to Nicor's assertion is the following:

The Commission finds that the allocation of firm storage capacity, including SBS entitlements, should be based upon the MDCQ, similar to the method approved in Nicor's last rate case. The Commission observes that the calculation of SBS entitlement was not contested in Nicor's last rate case and the final order in that proceeding does not lay out exactly how the approved SBS entitlement was calculated. Thus, it is necessary to evaluate the arguments of the parties and determine the appropriate numerator to use in calculating the SBS entitlements.

(Order (Sep. 20, 2005) at 119.) This text simply does not support Nicor's interpretation, however.

Nicor also contends that "if the Commission decides to base storage allocation on capacity, not actual cycling, 149.74 Bcf is still the incorrect number." Nicor does not contest that 149.74 Bcf is the non-coincident capacity of all of its storage fields. (Application for Rehearing at 26.) The Application for Rehearing fails to address the Commission's determination that the non-coincident capacity is the appropriate measure to use (i.e. that the maximum storage allocation is a function of total capacity). Nicor argues that some fields are still injecting gas in November, but this is irrelevant to the total capacity of its fields. That 149.74 Bcf actually may not be reached does not imply that it is incorrect as either the theoretical maximum or as the appropriate figure in determining the maximum storage allocation for any given customer. Since the Application for Rehearing fails to address these conclusions in the Order, it should be denied.

## **19. Maximum Daily Nomination**

Nicor asks for reconsideration of its proposal to reduce the nomination from 2x MDCQ to 1x MDCQ. The rejection was based on a lack of evidence, as well as the historical 2x level and a policy objective of greater rather than lesser flexibility for customers. Since the Application for Rehearing fails to address any of these points made in the Order, it should be denied.

## **20. Cycling**

Nicor proposed cycling targets of 90% of injections by November 1 and total withdrawals down to 10% of storage allocations by April 1. The Order accepted the 90% target but not the 10% target. Nicor contends that rehearing should be granted because the adoption of only one target does not truly require cycling. The determination in the Order is not an oversight, however; the record does not support the withdrawal target. Nicor itself historically has not met the target it proposes, and that target would unreasonably burden Transportation customers. Accordingly, rehearing should be denied.

**22. Daily Delivery Algorithm**

Nicor fails to state an issue for rehearing, or to request relief that can be granted on rehearing. Therefore, rehearing should be denied for this issue.

TA/IB:jt