

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

WPS Resources Corporation, Peoples)
Energy Corporation, The Peoples Gas)
Light and Coke Company, and)
North Shore Gas Company)

Docket 06-0540

Application pursuant to section 7-204 of the)
Public Utilities Act for authority to engage)
in a Reorganization, to enter into an)
agreement with affiliated interests pursuant)
to Section 7-101, and for such other)
approvals as may be required under the)
Public Utilities Act to effectuate the)
Reorganization.)

ADMINISTRATIVE LAW JUDGES' PROPOSED ORDER

January 23, 2007

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ADMINISTRATIVE LAW JUDGES' PROPOSED ORDER

By the Commission:

I. INTRODUCTION AND PROCEDURAL HISTORY

In an Application filed August 3, 2006, WPS Resources Corporation (“WPS Resources”), Peoples Energy Corporation (“PEC”), The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas Company (“North Shore”) (collectively, “Applicants”)¹ asked the Illinois Commerce Commission (“Commission”) for approval, pursuant to Sections 7-204 and 7-204A of the Public Utilities Act (“PUA”), of a “reorganization” by which WPS Resources would become the owner of all the common stock of PEC and would become the indirect owner of 100% of the common stock of the Gas Companies (the “Reorganization” or the “Merger”). 220 ILCS 5/7-204 and 7-204A. Applicants also sought approval pursuant to Sections 7-102 and 7-204A(b) of the PUA for entry by the Gas Companies into an affiliated interest agreement by which they would receive shared corporate and other services from WPS Resources and its subsidiary Wisconsin Public Service Corporation (“WPSC”). 220 ILCS 5/7-102. Applicants requested other approvals and findings in connection with the Merger, as more fully discussed in this Order. With their Application and in support thereof, Applicants filed materials and information required by Section 7-204A and the prepared testimony and exhibits of seven witnesses.

¹ Peoples Gas and North Shore are sometimes referred to in the Order as the “Gas Companies”.

Petitions to intervene were filed by: the Citizens Utility Board (“CUB”); Constellation NewEnergy – Gas Division, LLC (“CNE-Gas”); the Cook County State’s Attorney’s Office (“CCSAO”); the Environmental Law and Policy Center (“ELPC”); the People of the State of Illinois by the Office of the Attorney General (“AG”); the Utility Workers Union of America, AFL-CIO and UWUA Local Union No. 18007 (together, the “UWUA”); and Dominion Retail, Inc., Interstate Gas Supply of Illinois, Inc., US Energy Savings Corporation, MxEnergy, Inc. and Direct Energy Services, LLC (collectively “Retail Gas Suppliers” or “RGS”). All of these petitions to intervene were granted by the Administrative Law Judges (“ALJs”). Additionally, the City of Chicago (“City”) filed an appearance.

Pursuant to due notice as required by law and by the rules and regulations of the Commission, prehearing conferences were held in this matter before duly-authorized ALJs of the Commission at its offices in Chicago on August 15, November 17 and December 7, 2006. An evidentiary hearing was held on January 9, 2007. At the hearing, the testimony of the following witnesses, on behalf of Applicants, was admitted into evidence: Larry L. Weyers, Chairman, President and Chief Executive Officer, WPS Resources; Bradley A. Johnson, Vice President and Treasurer, WPS Resources; Lawrence T. Borgard, President and Chief Operating Officer – Energy Delivery, WPSC; Diane L. Ford, Vice President – Controller and Chief Accounting Officer, WPS Resources; James F. Schott, Vice President – Regulatory Affairs, WPSC; Ilze Rukis, Manager – Alternative Resources for WPSC; Thomas J. Flaherty, Senior Vice President, Booz Allen Hamilton, Inc.; Douglas M. Ruschau, Vice President and Treasurer of Peoples Gas and North Shore; Valerie H. Grace, Manager of the Rates Department of Peoples Gas; and Linda H. Kallas, Vice President and Controller of PEC and its subsidiaries.

The following witnesses presented testimony on behalf of the Staff of the Commission: Dianna Hathorn, Accountant in the Accounting Department of the Financial Analysis Division; Bonita A. Pearce, Accountant in the Accounting Department of the Financial Analysis Division; Sheena Kight-Garlich, Senior Financial Analyst in the Finance Department of the Financial Analysis Division; Dennis L. Anderson, Senior Energy Engineer in the Gas Section of the Engineering Department of the Energy Division; and David Rearden, Senior Economist in the Policy Program of the Energy Division. David J. Efron, a consultant specializing in utility regulation, presented testimony on behalf of the AG, CUB and the City. J. Richard Hornby, a consultant with Synapse Energy Economics, Inc., presented testimony on behalf of CUB and the City. Martin G. Kushler, Director of the Utilities Program for the American Council for an Energy-Efficient Economy, and Charles Kubert, Senior Business Specialist, presented testimony on behalf of ELPC. James Gennett, President of UWUA Local No. 18007, presented testimony on behalf of the Union. Finally, James Crist, President of Lumen Group, presented testimony on behalf of RGS. All of this testimony was admitted into the record.

Peoples Gas and North Shore provided public notice of proposed changes to the annual reconciliation periods specified in the Gas Companies’ Rider 2 (Gas Charge)

and Rider 11 (Adjustment for Incremental Costs of Environmental Activities), from a fiscal year basis ending September 30 to a calendar year basis ending December 31, to be implemented in connection with the Merger. Notice of these tariff changes was posted in public and conspicuous places in Peoples Gas' office in Chicago and North Shore's office in Waukegan.

On January 9, 2007, a Memorandum of Agreement ("MOA") among Applicants, CUB, CCSAO, ELPC, AG, UWUA and the City, identified as Joint Parties' Exhibit 1, was filed with the Commission. Section II of the MOA stated that the points listed therein constituted complete resolution of all contested issues in this docket among these parties. The MOA also stated that Staff was not a party to the MOA but that Staff had executed the MOA for the purpose of confirming that Staff did not and would not oppose the resolution of the remaining issues as set forth in Section II of the MOA. In the MOA, the parties thereto agreed to a number of additional conditions and commitments in connection with the Commission's approval of the proposed Reorganization. These conditions and commitments, along with others separately agreed to by Applicants as described in this Order, are included in Appendix A to this Order entitled "Conditions of Approval." On January 11, 2007, CNE-Gas made a filing which stated that it did not object to entry of the MOA, Joint Parties' Exhibit 1.

On January 11, 2007, an Agreement for Resolution of Issues in Docket 06-0540 among Applicants and RGS ("RGS Agreement") and identified as Applicants-RGS Joint Exhibit 1, was filed with the Commission. Section IV of the RGS Agreement stated that the points listed therein constituted a complete resolution of all contested issues raised by RGS in this docket for purposes of this docket. The RGS Agreement also stated that Staff was not a party to the RGS Agreement but that Staff had executed the RGS Agreement for the purpose of confirming that Staff did not and would not oppose the resolution of the remaining issues as set forth in the RGS Agreement. The commitments set forth in the Applicants-RGS Joint Exhibit 1 are set forth in Section IV.A.6.d of this Order and are also included in Appendix A to this Order.

On January 11, 2007, the record was marked "Heard and Taken" by the ALJs. A draft order agreed to by Applicants, CUB, CCSAO, ELPC, AG, UWUA, the City, RGS and Staff was filed with the Commission. On January 23, 2007, the ALJs' Proposed Order was served on all of the parties on the service list.

II. RELIEF REQUESTED

In the Application at hand, the Applicants requested the following findings and approvals:

- (a) the Commission's approval, under Sections 7-204 and 7-204A, to engage in the Reorganization, through which WPS Resources – by acquiring 100% of the common stock of PEC – will indirectly acquire 100% of the voting stock of the Gas Companies;

- (b) the Commission's approval, pursuant to Sections 7-204(c) of the PUA, of (i) Applicants' proposed allocation of synergy savings between shareholders and the customers of the Gas Companies, as reflected in a proposed rate plan, (ii) the Gas Companies' deferral for future recovery, through creation of a regulatory asset, of the costs to achieve synergy savings that are allocated to the Gas Companies, (iii) the Gas Companies' amortization of the regulatory asset beginning in 2010, and (iv) the Gas Companies' recovery of the annual amortization in any rate case filed by the Gas Companies using a test year beginning on or after January 1, 2010, and ending before or on December 31, 2013;
- (c) the Commission's approval under Section 7-102 of the PUA (to the extent required) to engage in the Reorganization;
- (d) the Commission's authorization, pursuant to Sections 7-101 and 7-204A(b) of the PUA, for entry by the Gas Companies into an affiliated interest agreement by which they will receive shared corporate and other services from WPS Resources and WPSC;
- (e) the Commission's approval of the proposed accounting entries associated with the Reorganization;
- (f) the Commission's approval, pursuant to Sections 9-201 and 9-220 of the PUA (220 ILCS 5/9-201 and 9-220), for the Gas Companies to change the reconciliation years in their Gas Charge (Rider 2) and Environmental Activities (Rider 11) tariffs from the 12 months ending September 30 to the 12 months ending December 31, so as to provide for annual reconciliation proceedings on a calendar year basis rather than the current fiscal year basis;
- (g) a finding by the Commission, pursuant to Section 7-204(f) of the PUA, that any adjustments made to the books of account of the Gas Companies for financial reporting purposes as a result of purchase or "push down" accounting for the Reorganization will be disregarded for regulatory reporting purposes and for ratemaking purposes in future rate proceedings;
- (h) a finding by the Commission, pursuant to Section 7-204(f) of the PUA, that should the Reorganization not close on or shortly after January 1, 2007, and should the Gas Companies be unable to fully mitigate the higher tax liability, the Gas Companies may reflect in future rate proceedings the revenue requirement impact of higher tax liabilities due to the recognition for tax purposes of a temporary reduction in Last In, First Out ("LIFO") gas in storage inventory as of the closing of the Merger; and

- (i) the Commission's authorization for taking such other measures in connection with the Reorganization as may be reasonably necessary for effecting the Reorganization.

Application at 7-10.

During the course of this proceeding, Applicants also filed a proposed Services and Transfers Agreement (the "STA") among PEC, Peoples Gas, North Shore and their affiliated interests. The STA had originally been filed for approval in Docket 06-0416. The STA would replace two existing agreement under which Peoples Gas, North Shore and certain affiliated interests acquire services and transfer or acquire certain assets to and from the parties to those agreements, and would govern these types of transactions by and between PEC, Peoples Gas and North Shore after the Merger closes.

III. THE PROPOSED REORGANIZATION

A. Identification of the Parties to the Reorganization and Their Affiliates

The following paragraphs describe the parties to the proposed Reorganization and their affiliates, based on information provided at pages 10-12 of the Application.

WPS Resources Corporation. WPS Resources, a Wisconsin corporation, is a holding company with five major energy-related subsidiaries: WPSC; Upper Peninsula Power Company ("UPPCo"); Michigan Gas Utilities Corporation ("MGU"); Minnesota Energy Resources Corporation ("MERC"); and WPS Energy Services, Inc. ("ESI"). These subsidiaries provide electric and natural gas energy and related services in both regulated and non-regulated energy markets. WPS Resources' regulated operations serve customers in Wisconsin, Michigan, and Minnesota, and its non-regulated businesses serve customers primarily in the northeastern United States, Texas, and Canada. In addition to the subsidiaries described in this section of this Order, WPS Resources also has several other, less substantial subsidiaries.

Wisconsin Public Service Corporation. WPSC is a Wisconsin corporation that provides regulated electric and natural gas utility service to more than 425,000 electric customers and 308,000 natural gas customers in northeastern and north central Wisconsin and a portion of Michigan's Upper Peninsula.

Upper Peninsula Power Company. UPPCo is a Michigan corporation providing regulated electric service to approximately 52,000 customers in Michigan's Upper Peninsula.

Michigan Gas Utilities Corporation. MGU is a Delaware corporation providing regulated natural gas service to approximately 161,000 customers in lower Michigan.

Minnesota Energy Resources Corporation. MERC is a Delaware corporation that provides regulated natural gas service to more than 200,000 customers throughout Minnesota.

WPS Energy Services, Inc. ESI is a Wisconsin corporation and WPS Resources' major non-regulated subsidiary. ESI is a non-regulated energy supply and services company serving commercial, industrial and wholesale customers, as well as aggregated groups of residential customers. ESI's operations are in Illinois, Maine, Michigan, Ohio, Texas, Virginia, and Wisconsin in the United States, and Alberta, Ontario, and Quebec in Canada, while its principal markets are the northeastern quadrant of the United States and adjacent portions of Canada. ESI owns and/or operates non-regulated electric generation facilities in Wisconsin, Maine, Pennsylvania, New York, and New Brunswick, Canada; steam production facilities in Arkansas and Oregon; and a partial interest in a synthetic fuel processing facility in Kentucky.

Peoples Energy Corporation. PEC, an Illinois corporation, is a holding company with four primary business segments: gas distribution; oil and gas production; energy assets; and energy marketing. Its gas distribution segment includes two regulated Illinois distribution companies, Peoples Gas and North Shore. PEC also owns an energy marketing business and an oil and natural gas production company. Other subsidiaries of PEC own interests in generating assets, which as of the date of the Application, PEC was in the process of divesting in connection with exiting this business segment. In addition to the subsidiaries described in this section of this Order, PEC also has a number of other, less substantial subsidiaries.

The Peoples Gas Light and Coke Company. Peoples Gas, an Illinois corporation, is an Illinois public utility providing regulated natural gas service in the City of Chicago. Peoples Gas serves approximately 830,000 customers.

North Shore Gas Company. North Shore, an Illinois corporation, is an Illinois public utility providing regulated natural gas service to approximately 155,000 customers in 54 communities in northeastern Illinois.

Peoples Energy Services Corporation ("PESC"). PESC is an Illinois corporation engaged in non-regulated energy marketing. PESC furnishes retail energy services to more than 31,000 customers in Illinois, Michigan and Ohio, providing a portfolio of products to manage energy needs of business, institutional and residential consumers. PESC recently obtained authorizations to expand its services into Ohio and New York.

Peoples Energy Production Company ("PEP"). PEP is a Delaware corporation engaged in oil and natural gas production. PEP primarily focuses on acquiring proven, onshore reserves with upside potential in a limited number of strategic supply basins, to which value can be added through drilling programs, production enhancements, and reservoir optimization. PEP's acquisition and drilling efforts concentrate primarily on natural gas.

Peoples Energy Resources Company, LLC ("PERC"). PERC is a Delaware limited liability company that owns several subsidiaries involved in various wholesale gas businesses, natural gas liquids businesses, and power generation development.

PERC and its subsidiaries are in the process of disposing of their interests in power generation assets and exiting this business.

B. The Reorganization Transaction

The proposed Reorganization would be implemented pursuant to an Agreement and Plan of Merger, dated July 8, 2006 (the “Merger Agreement”), among PEC, WPS Resources and Wedge Acquisition Corp. (“Wedge”), an Illinois corporation and wholly-owned subsidiary of WPS Resources. A copy of the Merger Agreement was provided as Attachment A to the Application. The Reorganization is structured as a reverse triangular merger transaction. Under the Merger Agreement, WPS Resources will acquire the stock of PEC in exchange for WPS Resources stock that WPS Resources will issue to PEC shareholders at the time of Closing. Wedge will be merged with and into PEC, with PEC being the surviving corporation. PEC will thereby become a wholly-owned direct subsidiary of WPS Resources. As a result, Peoples Gas, North Shore and PEC’s other subsidiaries will become wholly-owned indirect subsidiaries of WPS Resources. Application at 13.

PEC shareholders will exchange their common shares for a fixed amount of WPS Resources common stock. Under the Merger Agreement, each PEC common share outstanding immediately prior to the Reorganization will be converted into 0.825 shares of WPS Resources’ common stock. Based on closing prices on July 5, 2006 (the business day before news of the proposed transaction first became public), this would result in an approximate value of \$41.39 per share for PEC stock. This exchange rate would represent a premium to PEC shareholders of approximately 14.2 percent, based on the average closing prices for PEC stock for the twenty day period ending July 5, 2006 (the first business day after news of the proposed Merger became public), and approximately 14.9 percent, based on the closing price for PEC on July 5, 2006. After the closing of the Merger, current WPS Resources shareholders will own approximately 57.6 percent of the combined company, and current PEC shareholders will own approximately 42.4 percent. Application at 13.

C. Post-Closing Operations

After the closing of the Merger, WPS Resources will be the parent corporation of PEC and its subsidiaries, including the Gas Companies. WPS Resources will move its headquarters and principal corporate offices to Chicago, and will adopt a new name. (Application at 14.) During the course of this proceeding, WPS Resources and PEC announced that “Integrays Energy Group, Inc.” was chosen to be the new name of the parent company.²

²For simplicity, the parent company will be referred to throughout this Order as “WPS Resources” even in the context of discussing post-closing operations and activities.

After the closing of the Merger, the Gas Companies will each operate as a separate wholly-owned indirect subsidiary of WPS Resources. Neither of the Gas Companies will be combined with any other WPS Resources entity. Each Gas Company will retain its current name and Chicago area headquarters, continue to operate as an Illinois public utility in its current service territory, keep its current rate schedule (except for the changes to the Gas Companies' Riders 2 and 11 for which approval is requested in this proceeding), and will remain subject to Commission jurisdiction and applicable Illinois law and regulations. All of WPS Resources' current regulated subsidiaries will maintain their names and headquarters locations, including WPSC in Green Bay. The energy marketing businesses of WPS Resources (ESI) and PEC (PESC and Peoples Energy Wholesale Marketing, LLC) will be combined and headquartered in the Green Bay area, while maintaining an office and a strong local presence in the Chicago area. Application at 14.

Applicants state that the Gas Companies' approximately one million customers will not experience any disruption or other immediate change in their service as a result of the Reorganization. Applicants state that gas will continue to be delivered as demanded, and that the Gas Companies' customers will call the same numbers for service and billing inquiries and to report any emergencies, and will largely have the same employees serving their needs. Applicants state that WPS Resources and PEC are committed to a smooth transition following the closing of the Merger, so that the integration will be transparent and seamless to customers of the Gas Companies. Application at 14-15. Applicants' witness Mr. Borgard described the process by which Applicants are planning for the integration of the merged companies and their subsidiaries, and also planning for initial post-closing operations. Applicants' Ex. LTB-1.0.

Initially following the closing of the Merger, PEC will continue to provide shared corporate services to the Gas Companies, and the Gas Companies will continue to provide services to each other, pursuant to the STA that the Applicants presented in this proceeding (and later modified in accordance with certain Staff proposals, as described more fully elsewhere in this Order). The STA will replace an existing services agreement among PEC, Peoples Gas, North Shore and Peoples Development Inc., and an existing Personal Property Transfer Agreement among PEC, Peoples Gas and North Shore. Other currently-effective Commission-approved agreements between the Gas Companies or among the Gas Companies, PEC and other PEC subsidiaries will also remain in effect to facilitate continuity of existing operations.³

³Those agreements are the Renewed Storage Services Agreement dated August 21, 1987 between Peoples Gas and North Shore; the arrangement for borrowing and lending of funds between Peoples Gas and North Shore, approved by the Commission in Docket 04-0602; the arrangement for Peoples Gas and North Shore to borrow funds from PEC, approved by the Commission in Docket 04-0603; the Firm Transportation Services Contract dated September 10, 1996 between Peoples Gas and PERC; and the Firm Peaking Gas Supply and Services Agreement dated September 10, 1996 between PERC and Peoples Gas. Applicants' Ex. DLF-1.0 at 10-11.

At the same time, the Gas Companies will begin to be integrated into the WPS Resources system. WPS Resources will provide shared corporate services to PEC and the Gas Companies. The Gas Companies will become parties to WPS Resources' affiliated interest agreement governing shared services among WPS Resources, WPSC, and WPS Resources' other regulated subsidiaries. (A copy of this affiliated interest agreement was provided as Attachment B to the Application and as Applicants' Exhibit DLF-1.1.) During the course of this proceeding, Applicants state, they determined that following the closing of the Merger, a services company would be formed to provide shared services to all subsidiaries of the combined company. Applicants further state that they would commit to filing applications with the Commission, within 120 days after closing the Merger, for the approvals required in connection with formation and operation of the services company; this filing would also include a plan and schedule to reach full operation of the services company. Applicants' Ex. DLF-1.3 at 6-7.

D. Asserted Benefits of the Reorganization

Applicants state that the proposed Reorganization will provide a number of benefits for the customers of the Gas Companies and will not adversely affect the Gas Companies' customers, their employees, or the Illinois communities they serve. Applicants state that WPS Resources will provide the Gas Companies with a larger and stronger financial platform to support improvements to, and maintenance of, their respective distribution systems for the benefit of their customers. Applicants also state that customers will benefit from WPS Resources' plan to bring industry best practices and operational excellence to the combined company's operations. Application at 16.

Applicants state that the Reorganization is expected to produce significant savings over time. They state that approximately \$87 million of potential annual synergy savings allocated to the combined company's regulated subsidiaries are projected to be achieved over time. Applicants expect that it will take five years after closing of the Merger to realize this level of savings. A smaller amount of additional synergy savings will be allocated to the combined company's non-regulated subsidiaries. Applicants state that the greatest portion of these savings is expected to be realized in administrative and general costs. Additionally, Applicants estimate that the combined company and its subsidiaries will incur approximately \$186 million of non-recurring costs in order to achieve these savings. Applicants state that most of these costs will be incurred in the four years after the Merger closing. Application at 16-17.

According to the Applicants, the integration of the Gas Companies' administrative, managerial, and overhead functions into the WPS Resources system will permit the Gas Companies and their customers to benefit over time from consolidation and economies of scale associated with the larger and more diverse enterprise being created by the Reorganization. Applicants plan to achieve savings by eliminating redundancies and properly aligning the work force with work load, which they expect to do through normal attrition as much as practicable. Applicants state that these cost

savings mean that rates will be lower than they otherwise would have been absent the Reorganization. Application at 16.

Applicants assert that they are committed to maintaining and enhancing the service and support to the Gas Companies' service territories and the communities that they serve. Applicants state that WPS Resources has a long and strong tradition of providing such service and support through civic, community, and philanthropic efforts and that this tradition will continue after the Merger. Applicants state that WPS Resources recognizes it to be both in its own best interest and that of the communities that the Gas Companies serve, for the economic prospects of those communities to be enhanced, and for the Gas Companies to continue to maintain a strong local presence. Application at 17-18.

Applicants state that the Gas Companies have not had their base rates adjusted since November 1995 but were planning to file for base rate increases during 2006. These rate increase filings, however, were postponed to early 2007 as a result of the pending Merger and the filing of this Application for approval. This delay means that the new rates will not take effect until early 2008, Applicants state, and owing to the deferral of the rate increase filings, results in a benefit to the Gas Companies' customers. Applicants further state that they will not file for further general rate increases for the Gas Companies until at least 2009, to take effect in 2010. Application at 18-19. Applicants set out both in the Application, and in the direct testimony of their witness Mr. Schott, that under Applicants' rate plan, the 2007 rate case filings will be based on historic test years and will not incorporate any synergy savings expected to result from the Merger. Applicants' Ex. JFS-1.0. In any subsequent rate case filings, however, the full synergy savings will be incorporated.

Applicants further state that WPS Resources is willing to accelerate Peoples Gas' existing program to replace cast iron mains and upgrade ancillary equipment in its distribution system in Chicago. Applicants state that WPS Resources intends to approximately double Peoples Gas' rate of investment in this program, thereby reducing the time it will take to complete it. Applicants state that these efforts will speed the enhancement of the reliability and efficiency, and the reduction in operation and maintenance costs, of Peoples Gas' natural gas distribution infrastructure over time. Application at 19-20.

IV. DISCUSSION OF STATUTORY REQUIREMENTS AND REQUESTED APPROVALS

A. Section 7-204: Reorganization Approvals

The Applicants request approval of the Merger as a "reorganization" within the meaning of Section 7-204 of the PUA. Section 7-204 states, in relevant part, that:

For purposes of this Section, “reorganization” means any transaction which, regardless of the means by which it is accomplished, results in a change in the . . . ownership or control of any entity which owns or controls the majority of the voting capital stock of a public utility . . .

220 ILCS 5/7-204.

This very same statute further requires that the Commission make a series of findings, each of which is being addressed here and below.

1. Finding 1: “the proposed reorganization will not diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service.”

a. Applicants’ Position

Applicants’ witnesses Weyers, Johnson and Borgard addressed the impacts of the Merger on the ability of the Gas Companies to provide adequate, reliable, efficient, safe and least-cost public utility service. Applicants state that WPS Resources has a strong record of maintaining the financial strength of its regulated subsidiaries and operating them reliably, efficiently and safely. Applicants state that under WPS Resources’ ownership, the Gas Companies will provide adequate, reliable, efficient, safe and least-cost public service. Applicants stated that further enhancement to service is expected from the combined company’s operational efficiencies and economies of scale. Applicants state that WPS Resources’ commitment to industry best practices and operational excellence will help ensure that a high quality of service is provided to the Gas Companies’ customers. Applicants state that these initiatives will enhance customer satisfaction. Applicants’ witness Mr. Borgard testified that WPS Resources has a long history of being highly rated by customers and that WPS Resources intends that the same high level of service be delivered to the Gas Companies’ customers. Applicants’ Ex. LTB-1.0 at 4-13.

Applicants agree to have a number of conditions regarding service quality placed in the Order approving the Merger. These conditions were initiated by Staff witness Dennis Anderson of the Gas Section of the Engineering Department of the Energy Division. As testified to by Applicants’ witness Mr. Borgard, Applicants commit to the following conditions:

- (1) The Gas Companies will maintain their respective capital expenditure budgets and operation and maintenance budgets associated with their physical gas systems, specifically, distribution, transmission, measurement, and storage, for the aggregate period 2007 through 2009, at levels that will equal or exceed the actual capital and operation and maintenance expenditures, excluding unusual items of a non-recurring

nature, by each company during the aggregate three-year period of fiscal 2004 through fiscal 2006.

- (2) Peoples Gas will pay for the professional fees and costs of an independent outside consultant with appropriate experience and expertise to (i) conduct a study of Peoples Gas' cast and ductile iron main replacement program, and (ii) make recommendations regarding appropriate improvements to the program and its implementation. In order to start the study as soon as possible, Peoples Gas, with input from the Commission Staff, shall select the outside consultant and oversee the conduct of the study. The study shall: (1) assuming a consultant can be selected in a timely manner, be completed no later than March 1, 2007, so that it can be used in support of the rate case anticipated to be filed in early 2007 and discussed in Mr. Schott's direct testimony; (2) identify the main replacement criteria currently utilized by Peoples Gas (including the ZEI criteria resulting from the prior study commissioned by Peoples Gas); (3) determine how the existing replacement program criteria have been implemented by Peoples Gas; (4) determine the current status of the main replacement program; (5) recommend criteria for the replacement of cast and ductile iron main to be utilized on a going forward basis; (6) recommend a schedule for the replacement of cast and ductile iron main on a going forward basis; and (7) include an estimate of the costs for the replacement program based on the recommendations included in the study. A copy of the study, its recommendations and cost estimates shall be provided to the Director of the Energy Division upon completion.

Peoples Gas also commits to conduct follow-up studies at five year intervals of (i) the status of Peoples Gas' cast and ductile iron main replacement program; and (ii) make recommendations regarding appropriate improvements to the program and its implementation. The outside consultant used for the initial study would conduct these follow-up studies. If that consultant is unavailable for any reason, then Peoples Gas, with input from the Commission Staff, shall select the outside consultant and oversee the conduct of the study. A copy of the follow-up studies shall be provided to the Director of the Energy Division upon their completion. The Commission, through its Staff, shall determine when the follow-up studies are no longer necessary.

By agreeing to these studies, Peoples Gas would not be agreeing to be bound by the findings, conclusions and recommendations of the studies. Peoples Gas would reserve the right to dispute findings, conclusions and recommendations, and to propose alternative courses of action, in the 2007 rate case or other appropriate regulatory proceedings.

- (3) The Gas Companies will (i) provide the results of a query to identify all active non temperature compensating meters set outside and inactive non temperature compensating meters set outside which become active, to the

Director of the Energy Division as an email on a weekly basis; and (ii) stop installing and/or reinstalling non temperature compensating meters by the later of January 1, 2007, or the date an order in this case is entered, subject only to the availability of appropriate meters.

- (4) The Gas Companies commit to (i) conduct a study to determine the current status of the Automated Meter Reading (“AMR”) system operation by reviewing the number of malfunctioning units during the period 2004-2006; (ii) determine the amount of time required to repair and return to service malfunctioning AMR units for the period from 2004 to 2006; and (iii) create or update procedures regarding the Gas Companies’ practices for the identification and repair of malfunctioning AMR units. The Gas Companies shall inform the Commission of the current status of the AMR system and the time to identify and repair malfunctioning AMR units for the period 2004 – 2006 within 6-months of the closing of the proposed transaction and shall provide their procedures for identifying and repairing malfunctioning AMR units within 9-months of the closing of the proposed transaction. The Gas Companies shall also consult with Staff regarding the creation or updating of procedures regarding the Gas Companies’ practices for the identification and repair of malfunctioning AMR units. If any disagreements arise between Staff and the Gas Companies regarding the appropriate procedures to create or update, such disagreement shall be submitted to the Commission for resolution. A copy of this study and the final procedures shall be provided to the Director of the Energy Division.

Peoples Gas and North Shore would use reasonable efforts to gain access to the customers’ premises in order to successfully implement procedures related to the identification and repair of malfunctioning AMR units, but the success of any new or updated procedures would depend on customer cooperation.

- (5) The Gas Companies commit to conduct a study to determine the adequacy of their meter reading practices and their compliance with 83 Illinois Administrative Code Part 280 (“Part 280”) related to the timely reading of customer meters. This study must determine the number and the duration of unread meters for the time period 2004 to 2006 within 12 months of the closing of the proposed transaction. The Gas Companies shall also consult with Staff regarding the creation or updating of procedures regarding the Gas Companies’ procedures and practices that ensure meters are adequately read and the Gas Companies’ actions are in compliance with Part 280. If any disagreements arise between Staff and the Gas Companies regarding the appropriate procedures to create or update, such disagreement shall be submitted to the Commission for resolution. The Gas Companies shall provide a copy of these studies and the revised procedures to the Director of the Energy Division and the Director of the Consumer Services Division.

Peoples Gas and North Shore would use reasonable efforts to gain access to the customers' premises in order to successfully implement procedures related to the timely reading of customer meters, but the success of any new or updated procedures would depend on customer cooperation.

Applicants Ex. LTB-2.0 at 2-4.

Applicants have also agreed to the condition, proposed by UWUA witness Mr. Gennett, that Commission approval of the Merger "be conditioned on the imposition of an enforceable commitment by Applicants not to implement reorganization-related layoffs or reorganization-related position reductions among UWUA Local 18007 employees." Ex. UWUA-1.0 at 37; Applicants' Ex. LTB-2.0 at 8. In his testimony, Applicants' witness Mr. Borgard represented that Applicants are willing to make this commitment to provide a measure of security to the Gas Companies' represented employees. He testified that the reductions in staffing levels contemplated in the Applicants' synergies analysis do not include reductions in field operations personnel. Applicants' Ex. LTB-2.0 at 8.

Applicants' witness Mr. Borgard noted that, in addition to the conditions relating to the Gas Companies' service quality to which Applicants are agreeing as conditions to the Commission's approval of the Merger, Peoples Gas had recently agreed, in the Docket 06-0311 proceeding, to take additional actions which provide further assurance that the Gas Companies' service quality will at least be maintained in the future, and more likely improved. Applicants' Ex. LTB-3.0 at 2-3. As such:

- C. Peoples Gas will execute a Memorandum of Understanding with the Commission, pursuant to which Peoples Gas agrees to pay for and cooperate with a consultant retained by the Commission and performing under the direction and control of the Commission. The consultant will conduct a comprehensive investigation of Peoples Gas' compliance with the Commission's pipeline safety regulations, including (but not limited to) evaluation of record-keeping procedures, substantiation of pipeline safety inspection records, and verification of recorded pipeline safety conditions, followed by an audit of Peoples Gas' continuing actions to implement recommended improvements to its pipeline safety program.
- D. Peoples Gas agrees that it will bring the utility into compliance with the Commission's pipeline safety regulations, including conforming to prudent utility practices as generally understood in the industry and/or such practices as determined by Commission Staff in conjunction with Peoples Gas. In consultation with the Commission, Peoples Gas will develop a program to address the directives identified by the Commission's consultant set forth in paragraph C of this agreement.

Order, Docket 06-0311, Dec. 20, 2005 at 5.

Applicants, however, disagree with UWUA witness Mr. Gennett's proposal that the new management should commit to implement a formal apprenticeship and training program at Peoples Gas. Mr. Borgard testified that Peoples Gas already has training programs for its natural gas system operating personnel. Specifically, Peoples Gas has established training requirements for over 30 individual job classifications, including formal classroom instruction that ranges in length from a number of hours to programs lasting up to 20 days, depending on the particular job classification. Nevertheless, Mr. Borgard stated that Applicants were willing to enter into a dialogue with the UWUA, beginning immediately, regarding ideas for improvement for the training and advancement of Peoples Gas' represented employees. Applicants' Ex. LTB-2.0 at 8-9. In addition, Mr. Borgard testified that the consultant investigation, referred to immediately above in paragraph C, would include an analysis and report of training and qualifications of Peoples Gas' field personnel, among other things, citing Docket 06-0311, Appendix, p. 1. Applicants' Ex. LTB-3.0 at 4.

Applicants also disagree with the proposal of CUB-City witness Mr. Hornby that Applicants should be required to file a service quality plan in the Gas Companies' first rate case following the Merger, to be subject to review and approval by the Commission, and which would include specific service quality metrics to be measured and financial penalties to be imposed for failing to meet specified levels of these metrics. Applicants further take issue with the proposal of UWUA witness Mr. Gennett that Applicants should be required to submit transition plans to the Commission, addressing how Applicants intend to operate Peoples Gas following the Merger, and that public comment be allowed on these transition plans. Applicants asserted that both of these proposals go beyond the requirements of the PUA, and its requirement that the Commission find a proposed reorganization will not "diminish" a utility's service quality. Applicants also state that these proposals are unnecessary. Applicants point out that neither CUB-City witness Mr. Hornby nor UWUA witness Mr. Gennett have provided any evidence to show that the Merger will diminish the Gas Companies' service quality. Applicants' witness Mr. Borgard testified that, as described above, Applicants had committed to the specific conditions relating to the Gas Companies' service quality proposed by Staff witness Mr. Anderson. Applicants' Ex. LTB-2.0 at 4-5.

With respect to CUB-City witness Mr. Hornby's proposal, Mr. Borgard testified that Applicants are always willing to share data they gather relating to service quality with Staff and other parties, and to listen to suggestions about other metrics that may be of value, but that it is inappropriate to impose a particular set of service quality metrics on two utilities that happen to be the subject of a reorganization. He also pointed out that there is no generally agreed-upon set of metrics in the gas industry. Mr. Borgard stated that if the Commission were inclined to consider the establishment of natural gas service quality metrics, it should do so through a generic proceeding involving all the gas utilities in the State and other stakeholders. Applicants' Ex. LTB-2.0 at 5. With respect to Mr. Hornby's proposal that financial penalties be imposed for failure to meet a particular service quality goal, Applicants stated that this provision was not appropriate, for a number of reasons. Mr. Borgard testified that performance in a given category is

variable in any particular month, and may be affected by factors outside the control of the Gas Companies, such as weather; therefore, it is not realistic to establish a service performance “bar” for various metrics that must be met or exceeded in order to avoid financial penalties. Applicants’ Ex. LTB-2.0 at 6. He stated that it is not customary in Illinois to impose financial penalties on gas or electric utilities based on service quality performance. He explained that the imposition of such penalties would amount to a partial alternative regulation plan for the Gas Companies, but that alternative regulation plans must meet certain detailed criteria set forth in the PUA, that were not addressed in this proceeding. He further indicated that, in any event, it would be inappropriate to impose such requirements on the Gas Companies alone, and in the context of a Merger approval proceeding. *Id.*

With respect to UWUA witness Mr. Gennett’s proposal that Applicants should be required to file, for public comment, transition plans addressing how the Gas Companies will be managed after the Merger, Mr. Borgard stated that the concerns that appear to be the basis for this proposal were adequately addressed by Applicants’ commitment not to implement any reorganization-related layoffs or position reductions among Peoples Gas’ represented employees, by Peoples Gas’ current training programs, and by Applicants’ commitment to enter into a dialogue with UWUA Local 18007 concerning training programs. Applicants’ Ex. LTB-2.0 at 9. Mr. Borgard testified that, with respect to the operation of the Gas Companies’ distribution systems, WPS Resources intended to strive toward industry best practices and operational excellence, to operate safely, and to attain high levels of customer satisfaction. He also explained that post-closing implementation plans were being developed jointly by employees of WPS Resources and of the Gas Companies based on their specialized knowledge of systems operations and that this process would enable WPS Resources to conduct a thorough review of the Gas Companies’ specific systems and operating practices in order for the combined company to address potential issues or challenges and to identify potential opportunities for use of best practices. Applicants’ Ex. LTB-2.0 at 7.

Applicants also disagreed with the recommendation of ELPC witnesses Dr. Kushler and Mr. Kubert that, as a condition to approval of the Merger, the Commission should order the Gas Companies to establish and implement various energy efficiency programs. In the Applicants view, the adoption and implementation of energy efficiency programs are not appropriate topics for this proceeding under Section 7-204 and, therefore, the same are not appropriate subjects for conditions that would be imposed on the Commission’s approval of the Merger. Applicants noted that Dr. Kushler made no attempt to tie his proposal to any of the statutory criteria that the Commission must find to be satisfied in order to approve the Merger. Applicants also stated that the topic of adoption and implementation, through the utility, of programs to fund energy efficiency initiatives, is one that should be addressed in a rate proceeding or, alternatively, in a generic proceeding involving all of the State’s gas utilities (and possibly electric utilities). They note that the Commission itself concluded as much in the proceeding, *Northern Illinois Gas Company*, Docket 04-0779, a general rate case for that utility.

Applicants' witness Mr. Schott testified that in the rate case filings that will be made in early 2007, Peoples Gas and North Shore will propose a program to fund energy efficiency initiatives, and will include a proposal for recovery through rates of costs actually incurred on these programs. He pointed out that, in the rate case proceeding, ELPC and all other interested stakeholders will have a full opportunity to evaluate and comment on the Gas Companies' proposals and to propose alternatives. He stated that there are several reasons why any evaluation of whether to adopt energy efficiency programs, and of the specifics of such programs, should be conducted in a rate case rather than in a Section 7-204 proceeding for approval of a reorganization. According to Mr. Schott, any such programs should only be adopted in conjunction with adoption of an appropriate cost recovery mechanism or mechanisms, which necessarily should happen in a rate case. Mr. Schott also testified that there are numerous issues that would need to be addressed in deciding whether a utility should adopt energy efficiency programs and how the programs should be funded, and many of these issues have rate level and rate design implications. These issues include funding levels, eligibility criteria for benefits, types of programs to be supported, procedures for oversight and administration, levels of bill impacts to customers to provide funding, which classes should participate in funding and be eligible for program benefits, and rate design aspects of cost recovery (e.g., fixed charges versus volumetric). Mr. Schott noted that there are likely many stakeholders, such as industrial customers, who will have an interest in the resolution of such issues but who are not parties to this Section 7-204 proceeding, because there was no reason for them to expect that such issues would be addressed in a Section 7-204 proceeding for approval of a reorganization. Applicants' Ex. JFS-2.0 at 21-23. He emphasized that a party interested in the issues raised by ELPC's proposal would not have expected such issues to be raised, let alone addressed by the Commission in a holding company merger case, because ELPC's proposal did not involve any of the statutory criteria that are at issue for approval of the Merger. Applicants' Ex. JFS-3.0 at 14-15.

Applicants disagreed with the position of ELPC rebuttal witness Mr. Kubert that the statutory criterion in Section 7-204(b)(1) of the PUA makes this proceeding for approval of the Merger an appropriate forum to address the adoption of energy efficiency programs by the Gas Companies. Applicants pointed out that Section 7-204(b)(1) specifies that in order to approve a proposed reorganization, the Commission must find that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." 220 ILCS 5/7-204(b)(1). Applicants emphasized that the key word in this statutory provision is "diminish." *Id.* Mr. Schott testified that intervenors have presented no evidence that the Merger will result in any diminution of the efficiency, safety or cost effectiveness of the Gas Companies' service, or that the proposal concerning adoption of energy efficiency programs would cure any such diminution. Applicants' Ex. JFS-3.0 at 14.

Applicants' witness Ms. Rukis, Manager-Alternative Resources for WPSC, responded to the rebuttal testimony of ELPC witness Mr. Kubert. Applicants' Ex. IR-1.0. She testified that a set of four tests known as the California integrated resources tests were widely accepted as appropriate for assessing costs and benefits of a public benefit program such as energy efficiency programs and that it was inappropriate to focus on

just one of the tests. She testified too, that having shareholders pay for the costs of an energy efficiency program is not an appropriate method of mitigating the adverse rate impacts of energy efficiency programs and that, in any event, this will not insulate customers from adverse rate impacts. She stated that, all else being equal, a successful energy efficiency program that lowers the therm sales of a utility will require the utility to increase its retail rates to provide recovery of its fixed and variable costs including its return on rate base. She also stated that energy efficiency alone will not reduce average system costs because energy efficiency is proportional across all hours. Ms. Rukis testified that to result in a decrease of both peak demand and average system costs, an energy efficiency program must produce a reduction in statewide demand as a result of a comprehensive and ongoing statewide or regional energy efficiency strategy implemented by all utilities. She stated that because of the regional nature of natural gas markets, actions by individual utilities are unlikely to have the kind of impact on state-wide or regional demand that is required to reduce the market price of gas. Ms. Rukis also disagreed with Mr. Kubert's extrapolation of 2005 program cost and benefit data from MidAmerican Energy Company in Iowa to estimate costs and benefits of a program for Peoples Gas in the Chicago area. She stated that MidAmerican Energy's Iowa service territory consists of rural areas and much smaller cities and towns than Chicago and that its social and economic demographics, existing housing stock and new housing construction, equipment use and saturations are much different than those in the Chicago area. On this basis, she concluded that Mr. Kubert's estimates of benefits for a program for Peoples Gas in the Chicago area were speculative.

b. CUB-City Position

J. Richard Hornby, a consultant with Synapse Energy Economics, Inc., of Cambridge, Massachusetts, presented testimony on behalf of CUB and the City relating to the impact the proposed Merger would have on the customers of Peoples Gas and North Shore. CUB-City Exhibits 1.0 and 2.0. Mr. Hornby testified that, as structured, the Merger does not provide material benefits to customers in the form of cost savings or noticeable improvements in service quality. Mr. Hornby testified that the Applicants have not committed to specific measurable and enforceable targets for service quality. He noted that, though the Gas Companies already used several metrics to measure service quality, including the "Main Ranking Index" for cast iron and ductile iron main replacement, federal pipeline safety code measurements, and other customer service and safety measurements, these measurements will not measure customer service/satisfaction adequately and are not as comprehensive as those being used by other gas utilities to measure customer service/satisfaction. Furthermore, as with their cast iron replacement goal, Mr. Hornby averred that the Applicants' commitment to maintain current levels of performance is only meaningful if an order approving the Merger holds them to it. Mr. Hornby testified that the Applicants have not provided the Commission with a set of metrics and corresponding explicit quantified baseline or "status quo" levels of performance against which to measure the service quality implications of the proposed Merger. Without such a reference point, according to

Hornby, the Commission has few, if any, hard facts upon which to determine whether service quality will diminish.

Mr. Hornby pointed out that regulators in other states have conditioned their approval of mergers on the implementation of service quality metrics that can be measured and enforced. Mr. Hornby based his comparison on metrics used by the gas utility subsidiaries of WPS Resources in Wisconsin and Minnesota as well as by metrics reported by gas utilities in Massachusetts. Mr. Hornby testified that there are no gas industry standards for service quality metrics; however, he identified certain service quality metrics that are utilized by gas utilities in the state of Massachusetts. Mr. Hornby chose Massachusetts because gas and electric utilities in that state have been operating under a comprehensive service quality plan consisting of metrics, benchmarks and financial incentives since 2002. Mr. Hornby further testified that, the fact that the number of inquiries and complaints to the Commission's Consumers Division relating to Peoples Gas had roughly doubled from 1999-2000 to 2003-2005, is evidence that Peoples Gas should be using the additional service quality metrics he identified. In fact, by 2005 the Commission's Consumers Division was receiving more calls from customers of Peoples Gas than from customers of any of the state's other major gas or electric utilities.

Mr. Hornby recommended that the Commission impose a condition on its approval of the Merger that would have the Applicants file a gas service quality plan as part of the Gas Companies' first post-Merger general rate filing, and which would include proposed measures of customer service and safety, performance targets, financial penalties for not meeting the targets, the actual performance of Peoples Gas and North Shore on the proposed measures over the past five years, and the actual performance of the WPS Resources gas utilities in other states under the proposed measures over the past 5 years. The actual performance of Peoples Gas and North Shore on each of Mr. Hornby's proposed measures over the past 5 years would provide the Commission with a baseline or reference point against which to measure post-merger service quality. He indicated that this data would be necessary not only to ensure that there is no diminution in the quality of service but also to show that there is real improvement relative to past levels of performance. The service quality metrics that Mr. Hornby would have be included in the proposed gas service quality plan are: average response time to arrival for leak calls and number of response times greater than 60 minutes; number of recordable and lost time injuries; number of preventable vehicle accidents; percentage of locates completed on time; number and cause of damage to underground facilities; average speed to answer calls in call center; call center customer satisfaction; field service customer satisfaction; new service installation time; service appointments met as scheduled; in-cycle meter readings; Consumer Services Division cases; and residential billing adjustments. Mr. Hornby further recommended that the Applicants assess industry best practices and service quality plans of comparable utilities in other jurisdictions to develop the specific metrics. He proposed that Applicants evaluate the range of metrics currently used within the WPS Resources utilities as well as to examine metrics being used by other utilities,

particularly if Applicants truly want to emphasize industry best practices and operational excellence.

c. UWUA's Position

James Gennett, President of UWUA Local Union No. 18007, presented testimony on behalf of the UWUA. Exhibits UWUA-1.0 and UWUA-2.0. Mr. Gennett described the composition of the work force comprising UWUA Local No. 18007, which represents Peoples Gas' unionized work force. He stated that the Merger proposal was based in part on capturing savings through unspecified job reductions. Mr. Gennett noted the following areas of concern relating to the ability of Peoples Gas to provide necessary services: (1) Peoples Gas uses "baseline staffing", i.e., sufficient to accomplish routine and expected work, while utilizing contractors to handle peak-period work, which Mr. Gennett stated is inefficient and costly; (2) Peoples Gas has a poor customer service rating due in part to an understaffed and inadequately trained work force; (3) Peoples Gas operates an older, low-pressure gas distribution system but WPS Resources primarily has experience in operating a high-pressure system, therefore a Wisconsin worker may not be able to perform the same job in Chicago as in Wisconsin; (4) WPS Resources does not have a history of providing gas services in Chicago's complex urban environment; (5) WPS Resources does not yet have sufficient information to identify specific changes in the manner in which the Peoples Gas distribution systems will be operated, which should be addressed before the Merger is closed, not after; (6) Staffing reductions that would generate synergies are central to Applicants' proposal but have not been identified on a company-specific basis; although Applicants have stated there would be no reductions within the distribution function, there has been no commitment by Applicants that there will be no such reductions; and (7) Applicants have not conducted any studies on the impact of any staffing cuts on the quality, safety or reliability of the customer service provided by Peoples Gas.

Mr. Gennett testified that if the Merger is approved by the Commission, several conditions should be imposed to address staffing and training issues and ensure service quality. The conditions he recommended were: (1) approval should be conditioned on the imposition of an enforceable commitment by Applicants not to implement any reorganization-related layoffs or position reductions among Local 18007 employees; (2) WPS Resources should commit to implement a formal apprenticeship and training program at Peoples Gas; and (3) Applicants should be required to submit transition plans to the Commission and allow for public comment on them. Exhibit No. UWUA-1.0 at 37-39.

d. ELPC's Position

Martin G. Kushler, Ph.D., Director of the Utilities Program for the American Council for an Energy-Efficient Economy, submitted direct testimony on behalf of the ELPC. ELPC Exhibit 1.0. Dr. Kushler stated that the Commission has previously held,

in the Northern Illinois Gas Company rate case, that increased energy efficiency “lowers prices for everyone” and presents the state’s premier option for “lowering customer energy bills.” Docket 04-0779. He testified that high and volatile natural gas prices can harm consumers and result in an estimated \$7 billion dollars being drained annually from Illinois’ economy. He stated that well designed energy efficiency programs can typically save a unit of natural gas for less than half the cost of purchasing that same unit. Dr. Kushler also included data about the percentages of Illinois homes lacking attic insulation, wall insulation, energy-efficient windows, and programmable thermostats and concluded that there is great potential for improving energy efficiency in the Gas Companies’ service area. He testified that many customers do not make energy-efficiency investments at an appropriate level without incentives, outreach, and technical assistance.

Dr. Kushler recommended that as a condition for approving WPS Resources’ merger with PEC and the acquisition of PEC’s subsidiaries Peoples Gas and North Shore, the Commission should order Peoples Gas and North Shore to establish and implement energy efficiency programs. He stated that in Wisconsin, in recent years WPSC has been required to collect and contribute approximately 1.5% of its customer revenue for energy efficiency programs, a percentage that decreased to 1.2% in 2007. He testified that 1.2% to 1.5% of revenue would be an appropriate amount for Peoples Gas and North Shore to spend on energy efficiency programs for an initial five-year period. He stated that this amount would not create an undue burden on ratepayers. He stated that all customer classes should participate in the program but that the program should exclude distribution-only customers, i.e., customers who do not purchase natural gas from the Gas Companies. He stated that spending in the energy efficiency program should be allocated among customer sectors roughly in proportion to the share of funding for the program that is provided by each sector, but that additional assistance should be provided to low-income households. Dr. Kushler cited studies that found benefit-cost ratios ranging from 2.0-to-one to 5.3-to-1 for certain energy efficiency programs for certain sectors in Minnesota and Wisconsin. He stated that 23 states, including virtually every state with significant winter heating needs, currently have ratepayer-funded natural gas efficiency programs. Dr. Kushler discussed various types of programs that could be included in the energy efficiency program, including rebates for purchases of high efficiency furnaces, technical assistance and outreach, and installation of energy-efficiency measures in homes. He stated that the Commission should set a yearly budget, establish workshops for interested parties to discuss an appropriate portfolio of energy efficiency programs and their administration, and that the Commission should provide an oversight mechanism.

Charles Kubert, Senior Business Specialist at the ELPC, presented rebuttal testimony on behalf of ELPC. ELPC Exhibit 2.0. He testified that this proceeding was an appropriate forum in which to consider an energy efficiency program, based on Sections 7-204(b)(1) and 7-204(b)(7) of the PUA, which require the Commission to find that the proposed reorganization will not diminish the utility’s ability to provide “efficient, safe, and least-cost public utility service” and is not likely to result in any adverse rate impacts on retail customers, and Section 7-204(f) of the PUA, which allows the

Commission to impose any terms, conditions, or requirements it deems necessary to protect the interests of the public utility and its consumers. Mr. Kubert stated that energy efficiency programs ensure efficient and least-cost service and provide immediate and long-term rate relief, and also protect customers' interests by realizing significant savings on natural gas expenditures and lowering overall consumer costs. He stated that the costs of such a program included in base rates should be incorporated into operating expenses and built into the customers' distribution charge. He also discussed other methods of providing for the funding of a utility-supported energy efficiency program.

Mr. Kubert testified that all interested stakeholders had an opportunity to intervene in this proceeding. He also testified, however, that development of a detailed energy efficiency program for the Gas Companies' customers should be a collaborative process. He discussed benefit-cost ratios for evaluating energy efficiency programs including the utility benefit-cost ratio, which he stated was the most relevant test. He provided estimates of the benefits of an energy efficiency program for the Peoples Gas and North Shore service areas based on information reported by MidAmerican Energy Company with respect to the expenditures and results of its energy efficiency programs in the state of Iowa. Based on those data, Mr. Kubert estimated that a \$20 million investment by the Gas Companies in energy efficiency would result in approximately \$77 million in avoided gas purchases over the life of those energy-efficiency measures, which he stated represents almost a 4-to-1 benefit-cost ratio. Mr. Kubert further testified that those savings do not include the benefits of lower gas prices to all consumers due to the reduced purchase of expensive natural gas at the margin. Mr. Kubert testified that to the extent energy efficiency investments help to lower the peak demand of the utility, the utility does not have to procure as much natural gas on the margin. He stated that this should lower the average price paid for natural gas which is passed through to all customers. He stated that this benefit would increase over time and result in customers paying less for gas than they would have paid without making the energy efficiency investments. He estimated that five years of \$20 million annual energy-efficiency for the Gas Companies' consumers could reduce aggregate demand by 2.2%, resulting in less gas purchased at high prices and lower rates for all Gas Company consumers.

e. Staff's Position

Staff witness Dennis Anderson, a Senior Energy Engineer in the Gas Section of the Engineering Department of the Energy Division, addressed the Section 7-204(b)(1) requirement on behalf of Staff. Staff Ex. 4.0 (Corrected). Mr. Anderson identified a number of areas of the Gas Companies' operations that WPS Resources had not yet reviewed thoroughly or for which detailed plans for post-closing operations had not yet been developed. These areas included the Gas Companies' capital budgets for 2007 through 2009 and operation and maintenance ("O&M") budgets for 2008 and 2009; the Gas Companies' gas systems including Peoples Gas' cast and ductile iron main replacement program; potential installation of non-temperature compensating meters in

outside locations; potential problems with respect to the operation and maintenance of the Gas Companies' AMR systems; and whether the Gas Companies are reading customers' meters in compliance with 83 Illinois Administrative Code Part 280. Accordingly, Mr. Anderson proposed conditions to the Commission's approval of the Merger that would address each of the foregoing areas of concern. As described in Section IV.A.1.a of this Order, above, Applicants agreed to the conditions proposed by Staff witness Mr. Anderson, with minor modifications to certain of his proposed conditions that Mr. Anderson found to be acceptable. The text of the conditions is set out in Section IV.A.1.a above. Given Applicants' acceptance of conditions that were fashioned to address the areas of concern that Staff identified, Mr. Anderson recommends the Commission to find that the proposed Reorganization meets the requirements of Section 7-204(b)(1).

Staff witness David Rearden, Senior Economist in the Policy Program of the Energy Division, addressed ELPC's proposal that the Commission should impose a condition in its Order approving the Merger requiring the Gas Companies to implement energy efficiency programs. He testified that ELPC witness Kushler had not provided any connection between his proposed condition and the findings the Commission must make before a reorganization can be approved, nor had he shown that his condition was necessary to protect the interests of the utility or its customers or to protect the public interest. Dr. Rearden stated that the fact that not all interested parties had intervened in this proceeding made ELPC's proposal even more problematic, since stakeholders that could be harmed by the funding of the proposed energy efficiency programs may not be participating. Finally, Dr. Rearden stated that Dr. Kushler did not provide enough support for the notion that the system benefits of an energy efficiency program for all ratepayers exceed the increased rates paid by all ratepayers to fund the program. He noted that some ratepayers have already funded their own conservation measures but would be taxed to fund services for others. Staff Ex. 9.0 at 5-6.

f. Agreed Resolution of Issues in Joint Parties Exhibit 1

The MOA, i.e., Joint Parties Exhibit 1, provides an agreed resolution of the issues that were raised by CUB, the City, ELPC and the UWUA. The issues are described in detail per the above summaries of the positions of these parties, Applicants and Staff. The following provisions of Joint Parties Exhibit 1 address these issues:

Service-Related Proposals

- Peoples Gas and North Shore will conduct the operational studies described in Lawrence Borgard's rebuttal testimony to Staff witness' Dennis Anderson's proposal, Ex. LTB-2.0 at 2-4, to assist Applicants in improving customer service. The filing of a service quality plan and of specific metrics as proposed by CUB/City witness Mr. Hornby will not be required.

Energy Efficiency Programs and Funding

1. The Order in this Docket 06-0540 will impose a condition that, in their next rate cases, the Gas Companies will be required to propose to implement an energy efficiency program or programs. The condition shall also provide that:
 - (i) The Gas Companies shall propose energy efficiency program(s) in an aggregate annual amount of \$7.5 million.
 - (ii) The Gas Companies shall propose a cost recovery mechanism in their next rate case filings, and will be free to propose any cost recovery mechanism in the rate cases, whether recovery through base rates or through a rider mechanism. Regardless of the cost recovery mechanism that the Gas Companies propose in their next rate cases, the Gas Companies agree to support and implement the energy efficiency program(s) at the funding levels that the Commission approves, and for which it provides cost recovery, either in base rates or a rider, in the rate case orders.
 - (iii) The Gas Companies are not obligated to fund energy efficiency programs beyond the amount for which the Commission approves cost recovery in the rate case orders (as such orders may be modified as the result of any appeals). So long as the rate case orders do not require Applicants to fund energy efficiency programs in an amount greater than the amount for which the Commission provides cost recovery in such orders, either in base rates or a rider, and this amount does not exceed \$7.5 million, the Gas Companies will not seek to stay the portion of the rate case orders relating to energy efficiency programs and cost recovery.
 - (iv) Intervenors⁴ and Staff will be free to oppose the energy efficiency program(s) proposed by the Gas Companies in the rate cases, to propose modifications or alternatives to the energy efficiency program(s) proposed by the Gas Companies in the rate cases, to oppose the specific cost recovery mechanism proposed by the Gas Companies, and to propose different cost recovery mechanisms, provided that Intervenors shall not advocate that the Gas Companies be required to fund energy efficiency programs in any amount greater than \$7.5 million per year.

The parties recognize that other entities not parties to this Agreement could intervene in the rate cases and oppose implementation of any

⁴The term "Intervenors" as used in Joint Parties Exhibit 1 incorporates the following parties: CUB, CCSAO, ELPC, AG, UWUA and the City.

energy efficiency programs by the Gas Companies, oppose implementation programs of the size contemplated by this agreement, oppose recovery of some or all of the costs of such programs through rates, or support energy efficiency programs at sizes and funding levels greater than specified in this Agreement.

2. Applicants and Intervenors agree that the Applicants' 2007 rate case proposal should specify the details of the energy efficiency program(s), and agree to begin to work immediately together and with other interested parties in good faith to develop, agree on and present in the next rate case the details of such programs.
3. Applicants and Intervenors agree that a third-party administrator should implement the energy efficiency program(s).
4. Applicants and Intervenors agree that the Applicants will promote the energy efficiency program(s) through bill inserts and other appropriate mechanisms to be agreed upon prior to filing the 2007 rate cases.

Utility Workers Union of America, AFL-CIO, and UWUA Local No. 18007

1. Applicants commit that there will be no reorganization-related layoffs or reorganization-related position reductions among the UWUA Local 18007 employees.
2. Applicants will work in good faith with UWUA Local 18007 to reach agreement on identifying and implementing improvements to existing programs for the training and advancement of Peoples Gas' union employees that will build the skills of the union workforce and seek to ensure that the supply of skilled union employees is adequate as of now, and is replenished as required with appropriately trained, skilled and qualified employees.

Immediately upon consummation of the merger, Applicants and UWUA Local 18007 will begin a dialogue on the aforementioned issues. Applicants and UWUA Local 18007 may, by agreement, consult with key Staff at the Illinois Commerce Commission as needed on these issues. Applicants and UWUA Local 18007 shall file a joint report with the Commission in this docket within 90 days of the consummation of the merger. This report shall summarize the discussions to date and describe any improvements that have been or will be implemented. The report shall be filed on e-docket in "Public" and, if necessary, "Proprietary" versions.

The commitment stated herein is to a good faith effort by Applicants and UWUA Local 18007 to reach agreement, but not to a specific result or outcome in consequence of the dialogue.

3. Applicants will commit to the following staffing plan:
- Applicants will add nine (9) Crew Leaders by means of a promotional upgrade: five at North, two at Central and two at South.
 - Applicants will add eleven (11) Gas Mechanics by means of a promotional upgrade: five at North, three at Central, and three at South.
 - Applicants will add eleven (11) Operations Apprentices by means of new entry hiring: five at North, two at Central, three at South, and one in Special Projects.
 - Applicants will add eight (8) Senior Service Specialists (Grade No. 1) by means of a promotional upgrade: four at North, two at Central, and two at South.

g. Commission Analysis and Conclusion

On grounds that the Applicants have expressed their acceptance of the conditions proposed by Staff witness Anderson, we see Staff to recommend that the Commission find the proposed Reorganization to satisfy the criterion of Section 7-204(b)(1). In the same vein, we observe there to be a number of additional agreements and commitments by the Applicants that are reflected in Joint Parties Exhibit 1. These address the issues raised by CUB, the City, ELPC and the UWUA. We find these resolutions reasonable both in the circumstances and under the law. As such, the entirety of the agreed-to conditions and commitments is being included in Appendix A to this Order as conditions of approval. See Appendix A (Conditions 22-33).

We observe that no other party is contending that the proposed Reorganization does not satisfy the requirements of Section 7-204(b)(1). Nor is there an independent basis for such a concern. Thus, based on our review of the evidence of record, and taking account of the Applicants' commitment to the conditions proposed by Staff witness Mr. Anderson (as set out in Section IV.A.1.a above), and the additional commitments made by Applicants in the MOA (Joint Parties Exhibit 1, and set out in Section IV.A.1.f above), all of which are now conditions of approval, the Commission solidly finds that the proposed Reorganization will not diminish the Gas Companies' ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Stated another way, the Commission finds the proposed Reorganization to satisfy the criterion of Section 7-204(b)(1).

2. **Finding 2: “the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers.”**

The Applicants and Staff submitted testimony addressing whether the proposed Reorganization would satisfy the criterion of Section 7-204(b)(2) of the PUA. No other party presented testimony to address this requisite Commission finding.

a. Applicants’ Position

Applicants’ witness Diane L. Ford, Vice President – Controller and Chief Accounting Officer of WPS Resources, stated that WPS Resources has in place appropriate contractual requirements, allocation standards, and compliance processes to ensure that its non-utility activities, including the activities of its non-regulated subsidiaries, will not be subsidized by either the Gas Companies or their customers, and that the operations of one regulated subsidiary will not be subsidized by another. In her opinion, these measures keep corporate costs and inter-company transfers properly allocated. She further described how WPS Resources has successfully used similar measures to maintain proper cost allocation and accounting among its subsidiaries and to avoid cross-subsidization among them. Applicants’ Ex. DLF-1.0 at 3-9. Ms. Ford described the WPS Resources Affiliated Interest Agreement (“Regulated AIA”) which governs the provision of goods, services and property among WPS Resources and its regulated subsidiaries (WPSC, UPPCo, MGU and MERC). Applicants’ Exhibit DLF-1.1 is a copy of the Regulated AIA. Applicants proposed that PEC and its regulated subsidiaries, Peoples Gas and North Shore, be added as parties to the Regulated AIA. The Regulated AIA covers management, supervisory, construction, engineering, accounting, legal, financial, human resources, information services and other administrative services, as well as customer service and accounting, billing, plant operations, distribution operations, transmission operations and other services. In addition, the Regulated AIA governs the furnishing of property, employees, rights, interests or other things of commercial value among the parties. Applicants’ Ex. DLF-1.0 at 3-4. Ms. Ford also described the Master Affiliated Interest Agreement (“Non-Regulated AIA”) which governs the provision of services among WPS Resources, WPSC and WPS Resources non-regulated subsidiaries. *Id.* at 4. Applicants will add PEC and its non-regulated subsidiaries as parties to the Non-Regulated AIA. As a result, immediately after the Merger is closed, the Regulated AIA would govern the provision of services by WPS Resources and its subsidiaries (including WPSC) to Peoples Gas and North Shore, while the Non-Regulated AIA would govern the provision of services by WPS Resources and its subsidiaries to the non-regulated subsidiaries of PEC. *Id.* at 7-8.

In the course of this proceeding, Applicants submitted for approval the proposed Services and Transfers Agreement (the “STA”) among PEC, Peoples Gas, North Shore, PESC, PERC, PEP and Peoples-District Energy Corporation. Applicants’ Exhibit LK-1.2 is the proposed form of the STA as presented in this proceeding. The Gas Companies originally filed the STA for approval in Docket 06-0416 in response to the Commission’s

directives in its March 28, 2006 orders in Dockets 01-0707, 02-0727, 03-0705 and 04-0683 (annual Gas Charge reconciliation cases for Peoples Gas) and Dockets 01-0706, 02-0726, 03-0704 and 04-0682 (annual Gas Charge reconciliation cases for North Shore). The STA would replace two existing affiliated interest agreements: (1) an agreement among PEC, Peoples Gas, North Shore and Peoples Development, Inc. for the provision of services by any one of them to the other, dated July 17, 1969, and (2) the Personal Property Transfer Agreement among PEC, Peoples Gas and North Shore dated December 22, 1975. In addition to the named parties to the STA, which include PEC and all of its first-tier subsidiaries, each of the subsidiaries of the named first-tier subsidiaries is also made a party to the STA, except for certain specific exclusions. The STA also provides mechanisms for other PEC subsidiaries to become parties to the STA. The STA provides that, when a new company becomes a party to it, the Commission must be notified.

Applicants' witness Linda M. Kallas, Vice President and Controller for PEC and all its subsidiaries including the Gas Companies, described the STA. Applicants' Ex. LK-1.0. She stated that the STA sets forth procedures and policies that would govern transactions, including payment and charges for such transactions, between Peoples Gas and any non-utility party to the STA (including PEC), transactions between North Shore any non-utility party to the STA (including PEC), and transactions between Peoples Gas and North Shore. The STA also provides for the allocation of joint service costs among the parties. She testified that the STA would cover three types of transactions: (1) the provision by a party, in its sole discretion, for the use of facilities (defined to include office space, storage space, office furniture, fixtures and equipment, computer equipment, communications equipment, vehicles, and machinery, equipment, tools, parts and supplies) by another party; (2) the provision by a party, in its sole discretion, of services (defined to include administrative and management services, personnel services, purchasing services, operational services, and customer solicitation, customer support and other marketing-related services) to another party; and (3) the transfer of real property, tangible personal property and intangible assets, subject to any required Commission approval. Applicants' Ex. LK-1.0 at 8-9. Ms. Kallas also described other transactions among companies in the PEC corporate family that are excluded from, or not otherwise subject to, the STA. *Id.* at 9-11. Ms. Kallas stated that the STA does not obligate Peoples Gas and North Shore to provide services and facilities to affiliates whenever requested; rather, the STA allows a party, in its sole discretion, to determine whether and to what extent it will furnish facilities or provide services to a requesting party, and allows a party to decline the request for any reason or no reason. She stated that these provisions, among other things, enable Peoples Gas and North Shore to reject requests for services or facilities if compliance with the request could interfere with the Gas Companies' ability to provide its public utility services. *Id.* at 13.

Ms. Kallas described the provisions of the STA that define how charges are determined for transactions covered by the STA. Facilities and services provided by one of the Gas Companies to another party (including to the other Gas Company) will be priced at or above the provider's fully-distributed cost, unless the Commission has approved a different pricing mechanism. Facilities and services provided to the Gas

Companies by a non-regulated affiliate will be provided at the prevailing prices at which the non-regulated affiliate furnishes the facilities or services to non-affiliates if the provision of such facilities and services to non-affiliates constitutes a substantial portion of the non-regulated affiliate's revenues. Ms. Kallas stated that because of the "substantial portion" requirement, the prevailing price standard is expected to apply only to transactions where a non-utility subsidiary is the providing party; otherwise, such facilities and services will be provided to the Gas Companies at the non-regulated affiliate's fully distributed cost. Transfers of real property or tangible personal property between the Gas Companies will be at the cost of the property on the transferring party's books. Generally, all other transfers of real property or tangible personal property under the STA will be at fair market value. Finally, transfers of intangible personal property under the STA will generally be at fair market value, unless fair market value is not objectively or practicably determinable, in which case the transfer will be priced at the transferring party's fully distributed cost. Applicants' Ex. LK-1.0 at 11-13. Additionally, Ms. Kallas identified the provisions of the STA governing how payments are handled. *Id.* at 11.

Ms. Kallas identified a number of revisions that were being made to the STA (as reflected in the modified version provided as Applicants' Ex. LK-1.2) in response to requests and suggestions from the Commission Staff, to wit: (1) invoices will be issued for all transactions; (2) the STA will provide for Commission access to records of affiliated interests related to transactions with either of the Gas Companies under the STA; (3) the STA will include specific provisions concerning notices that must be provided to the Commission; (4) the STA will require PEC to perform an annual internal audit to test compliance with the provisions of the STA and to submit the internal audit report to the Commission; and (5) the STA will require the Gas Companies to submit an annual report to the Commission on transactions under the STA and specify the contents of the report. Applicants' Ex. LK-1.0 at 13-14.

Ms. Kallas testified that Applicants would provide to the Commission and to the Manager of the Commission's Accounting Department copies of the signed, executed STA and Regulated AIA that are being approved by the Commission in this proceeding, within 60 days after the date of the transaction. Applicants' Ex. LK-2.0 at 5. This filing requirement was proposed by Staff witness Ms. Hathorn in her direct testimony. Staff Ex. 1.0 at 21.

In Ms. Ford's additional testimony, she describes an arrangement Applicants have developed to govern the allocation and sharing of the costs to achieve associated with achieving the savings and benefits that are expected to result from the Merger. Applicants' Ex. DLF-1.3. She presented an "Agreement By and Among WPS Resources Corporation and Peoples Energy Corporation for Allocation of Incremental Costs Associated with Merger Transaction" ("CTA Agreement"). Applicants' Ex. DLF-1.4. The CTA Agreement adopts the allocation of the Merger-related costs among the companies in the post-Merger WPS Resources corporate family developed by Applicants' witness Thomas Flaherty in his direct testimony. The allocation factors for the various categories of Merger-related costs are set forth in Appendix A to the CTA

Agreement. Ms. Ford described the procedures for allocating Merger-related costs under the CTA Agreement. She stated that each of the subsidiaries in the combined company will separately account for costs-to-achieve actually incurred by identifying and categorizing them using the same categories identified by Mr. Flaherty by booking such costs as either expenses or capitalized costs as appropriate. On at least a quarterly basis, WPS Resources and PEC will each cause its respective subsidiaries to invoice it to reflect the current balance of all Merger costs incurred and so itemized and recorded. PEC will so invoice WPS Resources with a consolidated invoice related to its subsidiaries. Upon receiving these invoices, WPS Resources will allocate Merger costs in accordance with the allocation percentages in Appendix A to the CTA Agreement and compare the costs incurred by each subsidiary to the allocations. WPS Resources will then invoice its regulated subsidiaries (other than the Gas Companies) and PEC for their allocated amounts of Merger costs, net of their incurred Merger costs. With each such invoice, the subsidiary will either be compensated for its prior over-payment of allocated Merger costs or be required to make up its under-payment of allocated Merger costs over the invoiced period. PEC, as an intermediary between WPS Resources and PEC's subsidiaries, will perform such invoicing for its regulated subsidiaries pursuant to the proposed STA among PEC, Peoples Gas, North Shore and other PEC subsidiaries. Ms. Ford stated that because PEC, not WPS Resources, will invoice the Gas Companies for their allocated shares of the Merger costs pursuant to the STA, the Gas Companies are not parties to the CTA Agreement. Applicants' Ex. DLF-1.3 at 3-4. She stated that under the CTA Agreement, in combination with the STA, the costs-to-achieve actually incurred in the various cost categories listed in the CTA Agreement will be allocated to Peoples Gas and North Shore in accordance with the appropriate allocation percentages in Appendix A to the CTA Agreement. *Id.* at 4-5. Finally, Ms. Ford stated that the CTA Agreement provides for a five-year term because that is the period of time over which Merger-related costs are expected to be incurred. *Id.* at 6.

Ms. Ford also testified that post-closing, the combined company will form a services company to provide shared services to all subsidiaries of the combined company. She stated that Applicants would commit to filing applications with the Commission for the required approvals within 120 days after closing the Merger; this filing will include a plan and schedule to get to full operation of the services company. Applicants' Ex. DLF-1.3 at 6-7.

Applicants' witness Ms. Kallas testified that Applicants would accept conditions to the Commission's approval of the Merger that were recommended by Staff witness Ms. Hathhorn in connection with her evaluation of compliance with Sections 7-204(b)(2) and 7-204(b)(3) of the PUA. Applicants' Ex. LK-2.0 at 5. These conditions are as follows:

- (a) Provision to the Commission's Chief Clerk and to the Commission's Manager of the Accounting Department by March 31st of each year, all reports, studies, and any other inter-company transactions and compliance reports filings required of the Public Service Commission of Wisconsin ("PSCW").

- (b) Peoples Gas and North Shore shall not be charged for services in excess of WPSC's actual costs in providing such services.
- (c) PEC will notify the Commission each time a change is made in the cost allocation methodology by means of a letter to the Commission's Manager of Accounting, specifying what methodology is being changed and why the change is being made.
- (d) File simultaneously a copy of all reports required by the FERC concerning Peoples Gas' Operating Statement and Hub Services with the Commission's Manager of the Policy Program and Energy Division and Manager of Accounting.
- (e) File within 90 days of fiscal year end with the Commission's Manager of the Policy Program in the Energy Division and Manager of the Accounting Department a report that reflects all transactions of Peoples Gas and its affiliates which are described as Structured Services Hub Transactions offered pursuant to Peoples Gas' blanket certificate authority.
- (f) Peoples Gas and North Shore will provide the annual reports described in Section X.4 of the STA relative to the test period for the 2007 rate filings on the same date as their 2007 general rate case filings are filed with the Commission.
- (g) Applicants will file a plan, within 120 days of the closing, including a timetable, for development and implementation of a combined affiliate transaction system.

Staff Ex. 1.0 at 20.

b. Staff's Position

Staff witness Ms. Hathhorn, an Accountant in the Accounting Department of the Commission's Financial Analysis Division, testified concerning whether the proposed Reorganization would comply with the requirements of Section 7-204(b)(2). She stated that the Reorganization can be found to comply with Section 7-204(b)(2) if the Applicants are subject to certain conditions. Ms. Hathhorn observed that the Gas Companies have previously provided their cost allocation guidelines and procedures applicable to non-utility transactions required pursuant to 83 Illinois Administrative Code 506.20 and are in compliance with the internal audit requirements of 83 Illinois Administrative Code 506.30. She noted the Applicants to have stated that, at this point, they have no plans to change these guidelines due to the proposed Reorganization, but if they did determine a change is needed, the revised guidelines will be submitted to the Commission's Manager of Accounting. Ms. Hathhorn testified that these guidelines, when combined with the conditions she proposes in connection with her analysis of the requirements of Section 7-204(b)(3), are adequate to ensure that the Reorganization will not result in any unjustified subsidization. She recommends that, subject to the

adoption of her proposed conditions, the Commission find that the Reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers, as required by Section 7-204(b)(2). Staff Ex. 1.0 at 3, 20-21. As described in Section IV.A.2.a above, Applicants agreed to the conditions proposed by Ms. Hathhorn, including the conditions relating to the proposed STA and the Regulated AIA. In her rebuttal testimony, Ms. Hathhorn notes that Applicants had agreed to her proposed conditions. Staff Ex. 7.0 at 3-5.

c. Commission Analysis and Conclusion

Based on the evidence of record and in light of Applicants' acceptance of the conditions proposed by Staff witness Ms. Hathhorn, the Commission is well-assured in concluding that the Reorganization will not result in the unjustified subsidization of non-utility activities by the Gas Companies or their customers. The conditions accepted by Applicants are being included in Appendix A to this Order as conditions of approval. See Appendix A (Conditions 4-11). Furthermore, we note that no party is contending that the criterion of Section 7-204(b)(2) will not be met. Accordingly, the Commission finds that the proposed Reorganization satisfies the criterion of Section 7-204(b)(2) of the PUA.

3. **Finding 3: "costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes."**

The Applicants and Staff submitted testimony addressing whether the proposed Reorganization would satisfy the criterion of Section 7-204(b)(3) of the PUA. No other party presented testimony on this matter.

a. Applicants' Position

The evidence submitted by Applicants concerning compliance with the requirements of Section 7-204(b)(3) is also applicable to show that the Reorganization will meet the requirements of Section 7-204(b)(3). Applicants' witness Ms. Ford described WPS Resources' systems for ensuring a fair and accurate allocation of costs and facilities between utility and non-utility activities within and among its subsidiaries. Applicants stated that the Gas Companies will be incorporated into these systems, while at the same time continuing to adhere to the Commission's Uniform System of Accounts for Gas Utilities ("USOA"). Ms. Ford explained that the Commission will have sufficient information to determine the costs and facilities that are properly included by the Gas Companies for ratemaking purposes. Additionally, as described in detail in Section IV.A.2.a, above, and with respect to the requirements of Section 7-204(b)(2), Applicants note that: (i) PEC, Peoples Gas and North Shore proposed to enter into the STA, as modified in accordance with Staff's recommendation, for the provision of services and

facilities and transfers of property between and among these companies and other PEC subsidiaries; (ii) Applicants stated that post-closing, the combined company will form a services company to provide shared services to all subsidiaries of the combined company, and committed to filing applications with the Commission for the required approvals within 120 days after closing the Merger, including a plan and schedule to get to full operation of the services company; (iii) the Merger-related costs to achieve would be allocated among all of the companies in accordance with the allocation factors in Appendix A of the CTA Agreement presented by Ms. Ford; and (iv) Applicants agreed to the other conditions proposed by Staff witness Ms. Hathhorn relating to compliance with the requirements of Section 7-204(b)(3).

b. Staff's Position

Staff witness Ms. Hathhorn testified concerning whether the proposed Reorganization would comply with the requirements of Section 7-204(b)(3). In her view, the Reorganization can be found to comply with Section 7-204(b)(3) if the Applicants are subject to certain conditions. Ms. Hathhorn noted that Applicants have requested approval of the Regulated AIA and the STA. She stated that the Regulated AIA provides the mechanism for charges from WPS Resources and its affiliates to be allocated to the Gas Companies. She stated that the STA provides the mechanism for charges for PEC and its affiliates to be allocated to the Gas Companies. She noted too, that both agreements are two-way agreements, meaning that charges can either be charged to or billed from the utilities. Ms. Hathhorn testified that the Regulated AIA already provides for significant inter-company transactions and compliance reports to the Wisconsin Commission. She stated that the STA incorporated many of Staff's suggested reporting, auditing and notification controls. Staff Ex. 1.0 at 4-5.

As described in Section IV.A.2 above, Ms. Hathhorn recommended imposition of a number of conditions on the Commission's approval of the Reorganization, Staff Ex. 1.0 at 5-9, and Applicants agreed to Ms. Hathhorn's proposed conditions. Ms. Hathhorn recommends that subject to adoption of her proposed conditions, the Commission should find that costs and facilities will be fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities that are properly included by the utility for ratemaking purposes. She also recommends that the request to replace two existing PEC affiliate agreements with the STA should be granted. Staff Ex. 1.0 at 8-9. In her rebuttal testimony, Ms. Hathhorn noted that the Applicants have accepted her proposed conditions and that as a result there were no contested issues with respect to the required finding under Section 7-204(b)(3). Staff Ex. 7.0 at 3-6.

c. Commission Analysis and Conclusion

Based on the evidence of record and in light of Applicants' acceptance of the conditions proposed by Staff witness Ms. Hathhorn, the Commission reasonably

concludes that the Reorganization will result in costs and facilities being fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities that are properly included by the utility for ratemaking purposes. The conditions accepted by Applicants are being included in Appendix A to this Order as conditions of approval. See Appendix A (Conditions 4-11). We note further that there is no evidence to show, and no party is contending, that the criterion of Section 7-204(b)(3) will not be met. Accordingly, the Commission concludes that the proposed Reorganization satisfies the requirements of Section 7-204(b)(3) of the PUA.

4. Finding 4: “the proposed reorganization will not significantly impair the utility’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.”

The Applicants and Staff submitted testimony addressing whether the proposed Reorganization would satisfy the criteria of Section 7-204(b)(4) of the PUA. No other party presented testimony that addresses these criteria.

a. Applicants’ Position

Applicants stated that, given WPS Resources’ strong financial condition, the Gas Companies will continue to have access to both long-term and short-term capital markets at reasonable cost and that in fact such access will be enhanced with WPS Resources’ larger, more diverse, more financially secure platform. Applicants also stated that for similar reasons, the Reorganization will strengthen the Gas Companies’ ability to maintain a reasonable capital structure. Applicants stated that the Gas Companies’ current credit ratings were expected to be enhanced as the result of WPS Resources’ relative financial strength. Application at 24. Applicants’ witness Mr. Johnson, Vice President and Treasurer of WPS Resources, testified that the combination of PEC with WPS Resources, which has higher credit ratings, should provide the Gas Companies with access to the short- and long-term capital markets on better terms than would have been possible absent the Merger. He cited published commentary, by two rating agencies, that supported the potential for PEC’s ratings to improve as a result of the Merger. He also stated that WPS Resources would maintain its current credit profile by maintaining appropriate equity ratios in its capital structure given the ultimate business mix of the combined company. Mr. Johnson also testified that the combined company would have improved stock liquidity which should improve WPS Resources’ access to the equity markets. Applicants’ Ex. BAJ-1.0 at 4-5.

b. Staff’s Position

Staff witness Sheena Kight-Garlich, Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Commission, analyzed the

proposed Reorganization under Section 7-204(b)(4) as well as Section 6-103 of the PUA (220 ILCS 5/6-103). She concluded that the proposed Reorganization satisfied the requirements of Sections 7-204(b)(4) and 6-103. She testified that PEC and the Gas Companies currently have access to the capital markets on reasonable terms and that the Reorganization would not significantly impair the Gas Companies' access to the capital markets. She testified that, in the near term, WPS Resources' higher issuer credit ratings could potentially improve the Gas Companies' access to the capital markets. With respect to Section 6-103, Ms. Kight-Garlich testified that the capitalization of the Gas Companies following the Reorganization would not exceed the fair value of the property involved in the Reorganization and, therefore, the proposed Reorganization satisfied this requirement of Section 6-103. Staff Ex. 3.0 at 2-4.

c. Commission Analysis and Conclusion

Based on the evidence of record, the Commission concludes that the Reorganization will not significantly impair the Gas Companies' ability to raise capital on reasonable terms or to maintain a reasonable capital structure. Notably, no party is contending otherwise. Accordingly, the Commission here finds that the proposed Reorganization satisfies the criterion set out in Section 7-204(b)(4) of the PUA.

5. Finding 5: "the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities."

The Applicants and Staff addressed whether the proposed Reorganization would satisfy the criteria of Section 7-204(b)(5) of the PUA. No other party addressed these criteria.

a. Applicants' Position

Applicants stated that the Gas Companies will each remain Illinois public utilities following the Reorganization and that, as a result, the Gas Companies will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. Application at 25. Applicants' witness Mr. Weyers, Chairman, President and Chief Executive Officer of WPS Resources, testified that the Gas Companies will retain their current names, will continue to operate as Illinois public utilities, and will continue to be subject to Commission jurisdiction and applicable Illinois law and regulations. Applicants' Ex. LLW-1.0 at 8.

b. Staff's Position

Staff witness Bonita A. Pearce, an Accountant in the Accounting Department of the Financial Analysis Division of the Commission, testified that the Reorganization met the requirement of Section 7-204(b)(5) that the Gas Companies will remain subject to all

applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. Staff Ex. 2.0 (Corrected) at 35-36.

c. Commission Analysis and Conclusion

On the basis of the record evidence, the Commission concludes that following the Reorganization, Peoples Gas and North Shore will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. To be sure, no party or evidence suggests otherwise. Accordingly, the Commission finds that the proposed Reorganization satisfies the requirements in Section 7-204(b)(5) of the PUA.

- 6. Finding 6: “the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction.”**

a. Applicants’ Position

Applicants state that WPS Resources is not planning to acquire any electric generation facilities from PEC and add that PEC was actively engaged in selling its remaining interests in such facilities. Application at 25; Applicants’ Ex. JFS-1.0 at 13. Applicants further explain that the Gas Companies’ customers can purchase gas from alternative suppliers, and WPS Resources cannot exclude such suppliers from the Gas Companies’ systems. Application at 25-26. Applicants’ witness Mr. Schott stated that, because the Gas Companies have one-for-one gas cost recovery mechanisms in place, there is no incentive for the Gas Companies to exclude competitors. Applicants’ Ex. JFS-1.0 at 11-12. Mr. Schott stated that both PEC and WPS Resources have subsidiaries that are alternative gas and electric suppliers, but the combination of these entities will have no significant negative impact on retail markets. Citing Commission reports, Mr. Schott stated that there are many non-utility suppliers in the gas and electric markets. For example, in the gas market, the combination will result in an entity with a market share of less than 12%. *Id.* at 12-13. Responding to RGS witness Mr. Crist, Mr. Schott stated that changes to the Gas Companies’ choice programs, including those recommended by Mr. Crist, generally require tariff changes. According to Mr. Schott, a rate case, and not this proceeding, is the appropriate forum for many of Mr. Crist’s proposals. Further, Mr. Schott stated that the Gas Companies will not eliminate their choice programs under WPS Resources ownership. *Id.* at 23-24. In response to Staff witness Dr. Rearden, Mr. Schott stated that the Gas Companies are willing to have pre-rate case meetings with interested suppliers, including the RGS, and to address, in their rate case direct testimony, the proposals discussed in those meetings. *Id.* at 10-11.

a. RGS' Position

RGS witness Mr. Crist stated that prior to the announcement of the Merger, RGS had productive meetings with Peoples Energy and both had agreed to certain modifications to the Choices For You™ program. After the announcement of the Merger, he noted, those meeting were halted by Peoples Energy and no program changes were made. Additionally, given the lack of choice programs in WPS Resources' territory, Mr. Crist is concerned that the new entity may not see the continued need for choice programs and may not be amenable to making improvements to the program. JLC Ex. 1.0 at 2. Mr. Crist testified that the new entity should commit to growing and improving the Choices For You™ program and, towards that end, he recommended that the Commission, as conditions to its order approving the reorganization, require several changes to the programs, as detailed in his direct testimony. *Id.* at 6, 7-35. Mr. Crist also stated that competition could be threatened by the combination of the Applicants' retail marketing companies. *Id.* at 7. In response to Applicants' witness Mr. Schott and Staff witness Dr. Rearden, Mr. Crist stated that the most pertinent area of inquiry was not the unregulated gas supply market but the Gas Companies' service territories, where he stated that existing tariffs give the Gas Companies an unfair advantage over marketers, evidenced by the fact that only 2.3% of eligible customers have selected to take service under the Choices For You™ program. Ex. JLC 2.0 at 4, 12. Mr. Crist also believed that it is not necessary to wait for a rate case to make changes to the Choices For You™ program because many of the changes he proposes are administrative in nature and can be implemented immediately without changing tariffs. Some changes may require new tariffs, but most could be implemented after the expiration of the 45 day tariff filing period or earlier with Commission approval. Ex. JLC 2.0 at 10.

b. Staff's Position

Staff witness Dr. Rearden testified that the retail markets are characterized by low market concentration, and that tariffs have largely foreclosed a utility's ability to benefit its affiliates. Staff Ex. 5.0 at 6-7. Regarding retail electric markets, Dr. Rearden stated that these markets are undergoing dramatic change that holds more import for customers than the reorganization. He concluded that the reorganization will not harm the retail electric market. *Id.* at 10-11. Regarding retail gas markets, Dr. Rearden analyzed market shares and stated that there was a possibility of market power in Peoples Gas' territory, but he concluded that no problem exists because the tariff design does not seem to grant affiliates any special advantage. *Id.* at 11-12. In response to Mr. Crist's testimony, Dr. Rearden stated that the increases in market concentration resulting from the reorganization did not significantly harm competition, and it is unnecessary to adopt Mr. Crist's proposals in this proceeding in order for the Commission to make the finding required by Section 7-204(b)(6). *Id.* at 3-4. He recommends, however, that the Commission direct the Applicants to meet with Staff

and interested parties to consider Mr. Crist's proposals prior to the Gas Companies' next rate case filings. He further recommends that the Gas Companies address Mr. Crist's proposals in their rate case testimony. *Id.* at 1.

c. Agreed Resolution

On January 11, 2007, Applicants filed an Agreement for Resolution of Contested Issues as Applicants-RGS Joint Exhibit 1. In this record document, Applicants and RGS agree as follows:

I. Actions to be taken by the Gas Companies outside their upcoming rate case filings

Within 90 days following issuance of a final order in Docket 06-0540, the Gas Companies will make the following changes to their "Choices For You™" ("CFY") programs:

1. File tariff changes on 45 days notice to eliminate the requirement for a meter number to enroll a customer in the CFY program.
2. File tariff changes on 45 days notice to specify that only an account number shall be required to enroll a customer in the CFY program.
3. Eliminate the requirement that suppliers send a letter to customer when Peoples Gas or North Shore terminates service to a Rider SVT customer or does not enroll an ineligible customer in the CFY program.
4. File tariff changes on 45 days notice to eliminate the minimum pool size of 50 customers.

II. Actions that the Gas Companies will take in their upcoming rate case filings

In their upcoming rate case filings, which are expected to be made before the end of the first quarter of 2007, the Gas Companies will propose the following changes to the CFY programs:

1. Provision of Rate 1 customer lists (customer name and address) to Rider SVT suppliers on substantially the same terms and conditions that these lists are provided for commercial customers.
2. Billing the Aggregation Balancing Gas Charge ("ABGC") directly to Rider SVT customers.

3. Recovery of the gas cost-related portion of the Gas Companies' bad debt through their Gas Charges or another tariff rider and not through base rates.
4. As part of implementation of the rate case orders, improve the Gas Companies' billing systems related to electronic file transfer.
5. Elimination of the PEGAsys™ charges.
6. Address the \$10 enrollment charge for the CFY program, either by proposing to eliminate or modify this charge, or by presenting cost justification for continuing the \$10 enrollment charge

III. Issues to be discussed in workshops to be held prior to the Gas Companies' upcoming rate case filings

- A. The Gas Companies and RGS agree to meet and discuss the following issues relating to the CFY program in a series of meetings (to which other interested parties will be invited) to be held prior to the filing of the Gas Companies upcoming rate cases. The meetings are more fully described in III.B below.
 1. All items listed in Section II above.
 2. Possible PEGASys™ system improvements and the provision of more information about Required Daily Delivery Quantities ("RDDQ").
 3. Whether the provision requiring a meter read to have occurred within the previous 120 days in order for a customer to be enrolled in CFY can be eliminated or modified.
 4. Whether the tolerance level for the monthly Required Daily Delivery ("RDD") tolerance check can be raised to plus or minus 5%.
 5. Whether the requirement in the CFY program limiting eligibility to customers using a maximum 50,000 therms annually can be eliminated or modified.
 6. Whether the monthly RDD tolerance check can be eliminated.
 7. Whether upstream capacities can be allocated on a pro rata usage basis, or, alternatively, whether the ABGC can be eliminated or the calculation revised, based on review of the services being provided and the upstream assets and capacity being utilized.

8. Whether the cash working capital requirements relating to the Gas Companies' gas in storage inventory can be recovered through a rate mechanism that is paid only by gas sales customers of the Gas Companies.
 9. Whether the requirement that a customer returning from CFY to sales service from Peoples Gas or North Shore must remain on sales service for a minimum time before returning to CFY can be eliminated.
 10. Whether, and on what terms, the Gas Companies can, with customer authorization, provide customer payment history to a Rider SVT supplier.
 11. Whether, and on what terms, the Gas Companies can, with customer authorization, provide commercial customer tax identification numbers to a Rider SVT supplier.
 12. Whether wide band parameters can be provided allowing an alternate gas supplier ("AGS") to use storage to meet conditions caused by variance in the weather, under provisions pursuant to which the AGS decides how much gas to inject or withdraw to/from storage on a given day (within predetermined limits) in addition to the 10% band around RDDQ.
 13. Whether, and on what terms, the Gas Companies can purchase CFY supplier bad debt.
- B. The Gas Companies and RGS will attempt to begin the meetings during the week of January 15, 2007, and to meet regularly over the following weeks. The following other entities will be invited to participate in the meetings: ICC Staff; Illinois Attorney General; Citizens Utility Board; City of Chicago; Cook County State's Attorney' Office; and other AGS doing business or known to be interested in doing business on the Gas Companies' systems.
- C. The commitment stated in this Section III is a commitment to a good faith effort by the Gas Companies and RGS to meet, negotiate and attempt to reach mutually-acceptable resolutions of the issues listed in III.A.2 through III.A.13, and not to a specific outcome of any issue. However, issues on which an agreed resolution can be reached in a timely manner so as to allow submission in the Gas Companies upcoming rate cases will be included by the Gas Companies in their rate case filings.

Applicants-RGS Joint Exhibit 1 states that it constitutes complete resolution of the issues raised by RGS in Docket 06-0540 for the purposes of this docket, and that

Applicants and RGS will submit a draft order that incorporates the above-quoted agreements. Finally, Applicants-RGS Joint Exhibit 1 recites that it is being executed by Staff for the purpose of affirming that Staff does not and will not oppose the resolution of RGS' issues in Docket 06-0540 as set forth in Applicants-RGS Joint Exhibit 1, although Staff remains free to support, oppose or propose modifications to any proposal relating to any of the items listed therein when such proposal is filed by the Gas Companies with the Commission for approval. Separately, Applicants indicate that in connection with the meetings referred to in Applicants-RGS Joint Exhibit 1, the Gas Companies will make available to participants in the meetings, subject to a confidentiality agreement if necessary, information reasonably necessary for them to evaluate the issues listed in Applicants-RGS Joint Exhibit 1 to be discussed in the meetings and to identify potential solutions.

d. Commission Analysis and Conclusion

Based on the evidence of record, the Commission concludes that the proposed Reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction. The analyses presented by both Applicants' witness Mr. Schott, and Staff witness Dr. Rearden, show that the Reorganization is not likely to have a significant adverse effect on competition in either retail electric markets or retail gas markets in Illinois. To the extent that RGS raised issues about the effect of the Reorganization on competition in retail gas markets, these were resolved by the agreements set out in Applicants-RGS Joint Exhibit 1. In finding the resolution of the disputes to be reasonable and not contrary to law, the same are being included in Appendix A to this Order. See Appendix A (Conditions 34-36). The Commission takes note that, unless otherwise agreed between Applicants and RGS, RGS will not be precluded, in the Gas Companies' upcoming rate cases, from contesting the Gas Companies' positions or presenting RGS' own proposals on the topics listed in Applicants-RGS Joint Exhibit 1 in the event that proposals satisfactory to the RGS are not presented by the Gas Companies in the rate cases. On grounds of all the evidence at hand, the Commission finds that the proposed Reorganization satisfies Section 7-204(b)(6) of the PUA.

7. Finding 7: "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers."

a. Applicants' Position

Applicants stated that under the rate plan as originally presented in the Application and direct testimony, the Reorganization would have no adverse rate impacts on the retail customers of the Gas Companies. Applicants stated that the Gas Companies would file for rate cases in early 2007, that would result in rates effective in early 2008; and these rate cases would be based on historical test years with no

adjustments for either Merger-related synergy savings or Merger-related costs. Thereafter, the Gas Companies would not file for additional rate increases until 2009 at the earliest, for rates to be effective in 2010. Applicants stated that the change in control of the Gas Companies and their incorporation into the WPS Resources system would result in synergies and cost of savings to reduce the Gas Companies' overall cost of service below what it would have been absent the Reorganization. In the second and subsequent rate cases filed after the Merger, all of the savings resulting from the Reorganization allocated to the Gas Companies would be reflected in rates. Application at 26-27; Applicants' Ex. JFS-1.0 at 3-5. In his rebuttal and surrebuttal testimony, Applicants' witness Mr. Schott emphasized that Staff had concluded the Merger would not result in any adverse rate impacts on retail customers of the Gas Companies and that no other party had shown that there would be adverse rate impacts. Applicants' Exs. JFS-2.0 and JFS-3.0.

b. AG-CUB-City Position

Mr. David Effron presented testimony on behalf of the AG, CUB and the City concerning the treatment of the savings and costs resulting from the Reorganization. GCI Ex. 1.0. While Mr. Effron did not contend that the Reorganization would result in adverse rate impacts for retail customers of the Gas Companies, he did take issue with Applicants' plan not to reflect any synergy savings in the Gas Companies' rate cases to be filed in 2007 and with the Applicants' proposal for recovery of Merger-related costs. (This issue is discussed in detail in Section IV.B below.) In addition, Mr. Effron testified that any recovery of Merger-related costs should be subject to a showing by the Gas Companies that the actual Merger savings achieved and reflected in the Gas Companies' revenue requirements are at least as great as the recovery of Merger-related costs included in the cost of service. GCI Ex. 1.0 at 13.

c. Staff's Position

Staff witness Ms. Hathorn presented testimony addressing the requirement of Section 7-204(b)(7), i.e., that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers of the Gas Companies. Ms. Hathorn analyzed the potential rate impacts of the Merger on the customers of the Gas Companies, at the times of (1) the early 2007 rate case filings anticipated by Applicants and (2) the 2009 or later rate case filings, assuming a March 31, 2007 closing date for the Merger. Staff Ex. 1.0 at 9-12. She presented the results of her analyses in Schedules 1.1 and 1.2 to Staff Exhibit 1.0. The Staff analysis showed that the revenue requirement for a 2010 test year in a 2009 rate case filing would be \$13 million lower for Peoples Gas and \$2 million lower for North Shore with the proposed Reorganization than without it. Ms. Hathorn also noted that a similar analysis provided by Applicants in discovery, and which she included in Attachment A to her testimony, showed that the 2010 test year revenue requirement would be \$8 million lower for Peoples Gas and \$2 million lower for North Shore with the proposed Reorganization, than without it. She

stated that the principal differences between the Staff and Applicants' analyses were that: (1) the Staff analyses reflected disallowance, as recommended by Staff witness Pearce (and discussed in Section IV.B of this Order, below), of a portion of the Merger-related costs that Applicants sought to recover; and (2) the Staff analyses did not reflect the impact of inclusion in rate base of the projected amount of the deferred tax asset that would result from the LIFO-related impact on gas in storage due to PEC and the Gas Companies recognizing an income tax year-end on the closing date of the Merger. She emphasized (as discussed in Section IV.D of this Order, below) that Staff opposed Applicants' request for a finding that this deferred tax asset would be included in rate base. She stated that a March 31, 2007 closing date was chosen for the analyses because a March 31 closing was projected to result in the largest amount for the deferred tax asset. Based on her analyses, Ms. Hathhorn recommends that the Commission find that the proposed Reorganization is not likely to result in any adverse rate impacts on retail customers.

In her rebuttal testimony, Ms. Hathhorn commented on the potential rate impacts of proposals presented by various intervenor witnesses in their direct testimonies. She observed that, under the proposal of AG-CUB-City witness Mr. Effron (that some Merger-related synergy savings be reflected in the Gas Companies' 2007 rate filings and that Merger-related costs be amortized over a longer-period than proposed by Applicants), there would be net savings to ratepayers in 2007. In her assessment of Mr. Effron's testimony, Ms. Hathhorn believed that his proposal would not negatively affect the Commission's ability to find that the proposed Reorganization is not likely to result in any adverse rate impacts on retail customers. Staff Ex. 7.0 at 7. Ms. Hathhorn also discussed the proposals of ELPC witness Dr. Kushler that approval of the Reorganization be conditioned on establishing energy efficiency programs to be funded at the level of 1.5% of the Gas Companies' revenues; of CUB-City witness Mr. Hornby that approval of the Reorganization be conditioned on requiring the Gas Companies to file a gas service quality plan in their next rate cases; and of UWUA witness Mr. Gennett that the Commission impose conditions relating to staffing levels and training and apprenticeship programs. She stated that no evidence had been presented to show the rate impacts of these proposals. *Id.* at 7-8.

d. Commission Analysis and Conclusion

The analyses provided by both Staff and the Applicants show that the Reorganization is not likely to result in any adverse rate impacts. Nor is any other party contending that the proposed Reorganization will not meet the criterion of Section 7-204(b)(7). The Commission recognizes that the resolution, set out in Section IV.B of this Order, includes both Merger-related synergy savings and Merger-related costs in the Gas Companies' initial post-closing rate filings, in a manner not reflected in Applicants' original proposal nor analyzed in its specifics. We observe, however, that the agreed resolution of the Section 7-204(c) issue will result in net Merger-related synergy savings being reflected in the Gas Companies' 2007 rate case filings (*i.e.*, the amount of synergy savings to be included in the 2007 rate case filings will exceed the

annual amortization of Merger-related costs to be included in the 2007 rate case filings). In addition, the agreed resolution reflects that, in future rate cases, the Gas Companies will be required to show that Merger-related synergy savings reflected in the revenue requirement exceed the amortization to recover merger-related costs. Based on the evidence of record, the Commission finds that the proposed Reorganization is not likely to result in any adverse rate impacts on the retail customers of the Gas Companies, such that Section 7-204(b)(7) of the PUA is satisfied.

B. Treatment of Costs and Savings under Section 7-204(c)

Section 7-204(c) of the PUA, requires the Commission to rule on: (i) the allocation of any savings resulting from the Reorganization, and (ii) whether the Gas Companies should be allowed to recover any costs incurred in accomplishing the proposed Reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated. 220 ILCS 5/7-204 (c).

1. Applicants' Position

In their Application, Applicants state that the Reorganization was estimated to produce synergy cost savings of approximately \$177 million across the combined companies' regulated businesses through 2011, and that by using standard allocation methods, approximately \$77 million of these savings would be allocated to the Gas Companies over the five years after closing. Applicants stated that these allocated savings would have the effect of reducing the Gas Companies' costs, revenue requirements and rates. Applicants also stated that in addition to the stock exchange premium that would be paid by WPS Resources to PEC shareholders, the estimated total cost to the combined company of accomplishing the Reorganization and achieving the synergies and costs savings would be approximately \$186 million, of which about \$178 million would be allocable between regulated and non-regulated subsidiaries. Applicants stated that they would not seek recovery from the Gas Companies' customers of change-in-control costs and transaction costs, which totaled \$36 million. Applicants stated that of the remaining \$142 million of Merger-related costs, about \$47 million would be allocated to the Gas Companies. Application at 27-28.

Applicants' witness Thomas J. Flaherty, Senior Vice President with Booz Allen Hamilton Inc., presented testimony and exhibits to show the development of the estimated Merger-related synergy savings and costs to achieve and the allocation of savings and costs to the Gas Companies. Applicants' Exs. TJF-1.0 - 1.6. He identified and provided estimates of savings over the first five years after closing in the following categories: Staffing (Corporate and Utility); Corporate and Administrative Programs (Administrative & General Overhead, Benefits, Credit Facilities, Directors' Fees, Facilities, Insurance, Inventory, Professional Services, Regulatory Affairs, Shareholder Services and Transportation); Information Technology (Capital and O&M); Supply Chain (Contract Services and Materials & Supplies Purchases); and Fuel (Gas Supply). He

explained the sources of savings projected to be achieved in each of these categories and described the methodologies used by the Applicants to estimate the projected savings. He testified that the gross (*i.e.*, before consideration of costs to achieve) corporate and regulated savings were projected to increase from the first year following closing to the fifth year, in which year they were projected to reach approximately \$91 million; and that gross corporate and regulated savings were projected to total approximately \$373 million over the first five years following closing. Table 1 in Mr. Flaherty's testimony presented the estimated Merger-related cost savings in each of the categories used by Mr. Flaherty for each of the first five years after closing and, in total, over the five-year period.

Mr. Flaherty also presented testimony on the estimated Merger-related costs that would be incurred to achieve the savings and on the allocation of the total costs to the Gas Companies. He identified and estimated Merger-related costs in the following categories: separation costs, change-in-control costs, relocation costs, systems integration costs, facilities integration costs, internal and external communications expenses, regulatory process and compliance costs, integration costs, directors' and officers' ("D&O") insurance costs, and transaction costs. He described the nature of these costs and the methodologies used to estimate the costs in each of the categories. Exhibit TJF-1.3 shows the costs estimated to be incurred in each of these categories in each year over the five years following closing, and the total costs estimated to be incurred in each category over the five-year period.

Finally, Mr. Flaherty described the development of allocation factors to allocate Merger-related savings and costs among the companies in the post-Merger combined company, including the Gas Companies. Tables 2 and 3 to his testimony showed the factors, such as payroll and net property, plant and equipment, used to allocate savings and costs, respectively. Tables 4 and 5 showed the calculated allocation factors to be used in allocating savings and costs, respectively, at the combined company level to Peoples Gas and North Shore.

As described in Section IV.A.2.a of this Order, above, Applicants' witness Ms. Ford presented the Applicants' proposed CTA Agreement to govern the accounting for and allocation of Merger-related costs as they are incurred to the subsidiaries of WPS Resources and to PEC. Applicants' Ex. DLF-1.4. Costs allocated to PEC from WPS Resources pursuant to the CTA Agreement would then be allocated to the Gas Companies and other PEC subsidiaries pursuant to the STA. Appendix A to the CTA Agreement contains the specific allocation factors that will be used to allocate Merger-related costs. Ms. Ford testified that these are the same allocation factors developed by Applicants' witness Mr. Flaherty. Ms. Ford also testified that to the extent the Commission disallowed or capped any of the proposed Merger costs requested for recovery through a regulatory asset, the Gas Companies will account for and track the disallowed or "over cap" costs such that they will not be recovered from customers in any Commission-approved rates. She further testified that this accounting will be performed in a manner that enables Staff to verify that the disallowed or capped costs

have not been included in any revenue requirements proposed by the Gas Companies in future rate cases. Applicants' Ex. DLF-1.3 at 5.

Applicants' witness Mr. Schott described Applicants' plan for recovering Merger-related costs and for including Merger-related savings in the Gas Companies' rates. Applicants' Ex. JFS-1.0 at 3-7. Mr. Schott stated that the Gas Companies would file rate cases in early 2007 that would be based on historical test years and would not include any adjustments for Merger-related costs or savings. After these rate orders, the Gas Companies would not file subsequent rate increase until at least 2009, for rates to be effective no earlier than 2010. The rates approved in the second rate case would reflect the Gas Companies' allocated portion of the full Merger-related synergy savings achieved by Applicants. Additionally, Applicants proposed to defer and record Merger-related costs as a regulatory asset and to commence amortization of the deferred asset over a four-year period beginning January 1, 2010. Mr. Schott stated that the annual amortization of the Merger-related costs should be recoverable for any test period January 1, 2010 through December 31, 2013. He testified that a four-year amortization period was appropriate in order to mitigate the impact on rates of recovering the costs in a single year, because a four-year amortization period will approximate the period over which the costs are incurred, and because it will ensure that annual synergy savings will exceed the annual amortization of costs over the four-year period. In rebuttal and surrebuttal testimony, Mr. Schott also noted that a four-year amortization period for Merger-related costs was the same period proposed by Ameren Corporation and approved by the Commission in Docket 04-0294 relating to Ameren's acquisition of Illinois Power Company. Applicants' Exs. JFS-2.0 at 14 and JFS-3.0 at 7-9.

Referring to the categories of Merger-related costs identified by Mr. Flaherty, Mr. Schott testified that Applicants were not seeking to recover from the Gas Companies' ratepayers costs in the transaction costs and change-in-control costs categories, that total approximately \$36 million. He stated that Applicants should be allowed to defer and recover from the Gas Companies' customers the Merger-related costs in the categories of Separation, Retention, Relocation, System Integration, D&O Liability Tail Coverage, Regulatory Process, Facilities Integration and Communications. He stated that these costs were estimated to be \$142 million in total of which about \$47 million would be allocated to the Gas Companies. Applicants' Ex. JFS-1.0 at 5-6.

Mr. Schott testified that Applicants disagree with the proposal of Staff witness Ms. Pearce that none of the Communications costs and only 50% of the Regulatory Process costs should be allowed for recovery and that the recovery of Merger-related costs, in each of the individual categories identified by Mr. Flaherty, should be capped at the amounts estimated by Mr. Flaherty. He explained that the Communications and Regulatory Process costs were costs that must be incurred to achieve the Merger and its benefits, and therefore the portion of these costs allocated to the Gas Companies should be recoverable in full. He stated that these costs benefited all stakeholders, not just the combined company's shareholders as Ms. Pearce contended. Applicants' Ex. JFS-2.0 at 16-19. With respect to Staff's proposed caps on the amounts of recoverable costs in each category, Mr. Schott testified that such caps would not be advantageous

to customers because they could create an artificial barrier that could result in the loss of incremental synergy savings and benefits that may prove to be available if additional costs are incurred in a particular category. He also stated that such caps would be unfair to the Gas Companies. *Id.* at 19-21. In his surrebuttal testimony, however, Mr. Schott stated that Applicants accepted Staff witness Ms. Pearce's proposal to group the categories of Merger-related costs into three groups with a cost recovery cap to apply to each of the three groups. But he noted that Applicants continued to oppose the disallowances of Communications costs and 50% of Regulatory Process costs proposed by Ms. Pearce. Applicants' Ex. JFS-3.0 at 6-7.

Mr. Schott testified that Applicants oppose the proposals of Staff witness Ms. Pearce and AG-CUB-City witness Mr. Efron on the point that the Gas Companies should not be allowed to include carrying costs on the deferred Merger costs in the regulatory asset or to include the unamortized balance of the regulatory asset in rate base in the Gas Companies' 2009 rate cases. He stated that shareholders would carry the costs to achieve for over seven years (or longer if Mr. Efron's proposal for a longer amortization period were adopted) before they were fully recovered and that without inclusion of carrying costs, shareholders would not recover the real economic value of the merger-related costs that are authorized for recovery. He also noted that it was not necessary to disallow carrying costs in order for the Commission to be able to make the required statutory finding of "no adverse rate impact" from the Reorganization. Applicants' Ex. JFS-2.0 at 15-16. Additionally, Mr. Schott testified that Applicants' oppose Mr. Efron's proposals that the amortization period for the Merger-related costs should be ten years, not the four years as requested by Applicants, and that the amortization of merger-related costs should begin as the costs are incurred. Mr. Schott testified that the longer amortization period would force shareholders to wait an unreasonably long time before recapturing their investment that produced the benefits of the Merger for consumers. He also stated that costs for which the amortization begins before the amortization is reflected in rates would go unrecovered. According to Schott, Applicants were proposing to delay the start of the amortization and recovery of the Merger-related costs until the costs were more than offset by synergy savings and benefits. *Id.* at 14-15.

Mr. Schott testified that Applicants agree with several reporting and evidentiary requirements proposed by Staff witness Ms. Pearce at pages 22-23, lines 476-508 of her rebuttal testimony. Applicants' Ex. JFS-3.0 at 9. Those requirements, as proposed by Ms. Pearce, are detailed in Section IV.B.3 of this Order, below.

Finally, Mr. Schott testified that Applicants oppose Mr. Efron's proposal that both the synergy savings and Merger-related costs should begin to be reflected in the Gas Companies' rates in their 2007 rate cases. He stated that if Mr. Efron's proposal were adopted, the Gas Companies would have to reconsider their planned use of historical test years in the 2007 rate case filings and instead use fully forecasted 2008 test years incorporating additional rate base investments and ordinary expense increases and the impacts of continuing declines in usage per customer. He stated that a fully forecasted 2008 test year would produce a higher revenue requirement than would an historical

test year of the 12 months ended September 30, 2006. He also took issue with Mr. Effron's specific calculation of costs and benefits under his proposal. Applicants' Ex. JFS-2.0 at 8-12. Mr. Schott testified that there was no justification for including Merger-related synergy savings projected for 2008, as Mr. Effron proposed, in an historical 2006 test year (*i.e.*, pre-Merger). Applicants' Ex. JFS-3.0 at 6.

2. AG-CUB-City's Position

Mr. Effron recommended several changes to the rate plan proposed by the Applicants. He testified that customers should not have to wait until 2010 to see the benefits of the Merger, and recommended that the net savings enabled by the Reorganization should be reflected in the Gas Companies' revenue requirements in the first rate cases filed subsequent to Merger approval. Mr. Effron stated that in seeking the Commission's approval to engage in the Reorganization, the Applicants present the synergies to be produced by the Merger as evidence that the Merger is in the public interest. He stated that if the Commission approves the Reorganization based on these representations, it would be inconsistent and inappropriate to then ignore those synergy savings in establishing the Gas Companies' rates in the subsequent rate case. GCI Ex. 1.0 at 4, 9, 10.

Mr. Effron took issue with the Applicants' proposal that the Gas Companies would use the synergy savings allocated to them in the first three years after the closing to offset their alleged foregone revenue deficiency in those years associated with postponing the Gas Companies' planned 2006 rate filings. He stated that to ignore the Merger savings on the grounds that retention of such savings is necessary to compensate the Gas Companies for foregone increases to revenues that may or may not have actually taken place would be especially inappropriate. He added that compensating the Gas Companies in any manner after 2007 for these lost revenues would constitute a virtual text book example of retroactive ratemaking. That is, rates would be established to produce revenues in 2008 and 2009 in excess of the cost of service in order to compensate the Gas Companies for losses that supposedly took place in 2007. Mr. Effron stated that the fact that the losses for which recovery is sought are entirely speculative makes this example of retroactive ratemaking particularly egregious. *Id.* at 10.

Mr. Effron specifically disagreed with Applicants' position that it was a \$75 million benefit to customers when Peoples Gas and North Shore had deferred their planned rate case filings from mid-2006 to early 2007 as a result of the Merger. He testified that the quantification of such lost revenues, if any, must necessarily be entirely speculative, as it is not known just when the Gas Companies would have submitted rate applications in the absence of the proposed merger or what the rate change authorized by the Commission, if any, would have been. GCI Ex. 1.0 at 7. With respect to the \$75 million number, Mr. Effron testified that the Applicants provided no substantive support for this estimate. He noted that according to the response to AG Data Request 1.2, the \$75 million is "an order of magnitude number based on the publicly announced proposed

rate request of \$115 million, multiplied by 8/12, with eight being an estimate of the number of months the rate case would be delayed by the deferral announced with the filing, and then rounded to \$75 million.” *Id.* at 8. Mr. Efron’s own analysis of Peoples Gas’ return on equity in fiscal 2005, adjusted to normalize weather and eliminate the restructuring charges, was approximately 11.26%. He testified that this earned return on equity exceeds the return on equity awarded by the Commission in recent cases. Mr. Efron noted that he presents this analysis not to prove that Peoples Gas presently is earning excess revenues, or even to establish conclusively that there is no revenue deficiency, but rather to point out that it cannot be assumed that the Gas Companies have lost any revenues, much less \$115 million annually, as a result of delaying their rate applications. He states that it is entirely possible that the rate applications would have been postponed even in the absence of the proposed merger. *Id.* at 9.

Mr. Efron stated that if the Reorganization is approved and the Gas Companies use historical test years in rate filings shortly thereafter, then pro forma adjustments should be made to reflect the Merger savings. According to Mr. Efron’s testimony, the ratepayers should actually see the benefits that are cited as justification for approval of the proposed transaction, he testified. If the Merger is approved based on the representations that the savings will be achieved, then those savings should be reflected in the Gas Companies’ revenue requirements, according to Mr. Efron. He testified that if the synergy savings are reflected in the Gas Companies’ next rate cases, the recovery of the transition costs should also be reflected in those cases, but not on the terms proposed by the Applicants. He explained that, first, the amortization period of the transition costs should be longer than four years. He stated that while Applicants are correct that a four year amortization period mitigates the impact on rates as compared to recovering these costs in a single year, recovery of the transition costs in a single year is not a realistic option for the purpose of comparison. Recovery of the transition costs in one year would, in effect, be treating these one-time, non-recurring costs, as normal ongoing costs that are incurred annually in the normal course of operations, Mr. Efron stated. He testified that the transition costs are not annually recurring costs, and the costs are being incurred with the intention of producing benefits that will stretch for a period much longer than one year or, for that matter, much longer than four years. *Id.* at 10,11.

Mr. Efron stated that the fact that the costs will be incurred over a four-year period also does not control the appropriate amortization period. He testified that in theory, a proper matching of costs and benefits would mean that the costs should be amortized over the same period that the expected benefits will be realized. Given the extended period over which Merger benefits are expected to be realized, Mr. Efron recommended an amortization period of at least ten years. He testified that the amortization of the transition costs should begin as they are incurred. He stated that this will also achieve a better matching between costs and benefits than waiting until the rates in the Gas Companies’ next rate cases go into effect to commence the amortization of the costs to achieve. *Id.* at 11, 12.

Mr. Effron also disputed Applicants' position that if the Commission authorizes establishment of regulatory assets for the recoverable transition costs, there should be carrying costs accrued on those regulatory assets. He stated that the Applicants are not proposing to credit customers for the carrying costs on any lag in the reflection of synergy savings in rates. He noted that in 2008, the year the new rates are scheduled to go into effect, it is likely that the Gas Companies will begin to experience the benefits of the Merger savings. Mr. Effron said that even under his rate proposal, the Gas Companies will be able to retain those benefits for shareholders until the rates established in the cases filed after the Merger go into effect. Mr. Effron noted that the Applicants are not even proposing to credit customers for the savings that accrue before the new rates go into effect, let alone the carrying charges on those savings. He concluded that as a matter of symmetry, the Gas Companies should not be authorized to accrue and recover carrying charges on any deferred transition costs. *Id.* at 12.

Mr. Effron further testified that authorization to recover the deferred transition costs should be subject to a showing by the Gas Companies that the actual Merger savings achieved and reflected in the Gas Companies' revenue requirements are at least as great as the recovery of transition costs included in the cost of service. He noted that, in the responses to AG Data Requests 1.03 and 1.04, the Applicants agreed that the recovery of transition costs be limited to the demonstrated synergy savings. He testified that the earliest that the Gas Companies would need to "demonstrate" whether savings have actually been achieved would be in a rate proceeding in which recovery of transition costs are sought and the savings are implicitly (as opposed to explicitly) reflected in actual test year operation and maintenance expenses. Thus, Mr. Effron stated, if the Gas Companies file rate cases in early 2007, such demonstration would not be necessary under either the Applicants' proposal or his. In the subsequent rate cases, however, a demonstration of the achieved savings would be necessary, he concluded, assuming that the Gas Companies seek to include amortization of the transition costs in their revenue requirements. *Id.* at 13.

For purposes of demonstrating to the Commission that the achieved savings are at least equal to the transition costs for which recovery is sought, Mr. Effron referenced a two step method to measure achieved synergy savings proposed by the Applicants in their response to AG Data Request 1.03. First, a base line would be established. The base line would reflect the cost structure prior to the Merger, for example the pro forma operation and maintenance expense approved by the Commission in the rate cases filed in early 2007, exclusive of any pro forma adjustments for Merger savings or transition costs. Mr. Effron stated that according to the Applicants' response, in the future, actual costs would be compared to the selected base line, adjusted for known and measurable changes (the "adjusted base period"). Actual costs would then be compared to the adjusted base period to determine whether total costs have been reduced from the adjusted base line, Mr. Effron testified. Second, according to the Applicants' proposed methodology, savings from various synergy initiatives arising out of the Merger will be specifically identified and tracked, to ensure that the reduction in costs from the base line is due to synergies and not to other factors. The demonstrated savings would be deemed to be the lesser of the first and second calculations. *Id.* at 14.

Mr. Efron concluded that the Applicants' proposed method to demonstrate the achieved Merger savings is reasonable. Mr. Efron also stated that as an alternative to adjusting the base line for known and measurable changes in the first step, the base line could also be adjusted by a general inflation measure, such as GDP implicit price deflator, offset by a productivity factor. In addition, Mr. Efron testified that the Gas Companies should be required to demonstrate that the savings were not achieved by reducing or compromising the quality of service to customers. *Id.*

In his Schedule DJE-2, Mr. Efron quantified the synergy savings and transition costs that should be reflected in the Gas Companies' next rate cases, assuming the rate cases are filed shortly after the merger is approved. He calculated synergy savings net of the amortization of transition costs, based on the forecast of savings in the second year after the Merger closing. Mr. Efron testified that he chose the second year after the Merger closes for the purpose of quantifying the net Merger savings for two reasons. First, in Year 2, the Merger savings will have substantially completed their "ramp up" and will be close to their steady state, as described in the testimony of Applicants' witness Flaherty. Second, if the Gas Companies file rate cases shortly after the Merger is completed, Year 2 will approximately match the first year of the new rates established in those cases. Mr. Efron stated that the Gas Companies will retain any benefits of the merger for investors in the first year after the Merger, but when the new rates go into effect, the Merger savings should be reflected in the determination of the Gas Companies' revenue requirements. *Id.* at 14-15.

In calculating the gross Merger savings, as reflected on his Schedule DJE-2, Mr. Efron began with the gross Merger savings, which are the same as the savings for Peoples Gas and North Shore shown on Applicants' Exhibit TJF-1.6. He then deducted the gas supply savings because any such savings would be automatically flowed to customers through the Gas Companies' purchased gas adjustment mechanism rather than be credited to the base rate revenue requirement. He concluded that the gross Merger savings applicable to the base rate revenue requirement of Peoples Gas are \$21,463,000 and the gross Merger savings applicable to the base rate revenue requirement of North Shore are \$3,048,000. With respect to the costs to achieve synergy savings, Mr. Efron testified that he began with the total costs to achieve savings applicable to Peoples Gas and North Shore as shown on Applicants' Exhibit TJF-1.5 and TJF-1.6. He then eliminated the change in control costs and transaction costs, as the Applicants have stated that they will not seek to recover those costs from ratepayers. Mr. Efron also stated that he eliminated the write-off of systems costs in Year 4 from the total of the costs to achieve. This write-off is included in the System Integration Costs in Year 4 on Applicants' Exhibit TJF-1.3. Until the write-off actually takes place in Year 4 following the Merger, according to Mr. Efron, any of the system costs that are properly allocable to Peoples Gas and North Shore are already included in their revenue requirements. Therefore, he stated, this elimination is necessary to avoid a double recovery of the costs that will ultimately be written off. After these adjustments, Mr. Efron calculated costs to achieve of \$32,408,000 allocable to Peoples Gas and costs to achieve of \$4,376,000 allocable to North Shore. Amortizing these

costs over ten years, as proposed by Mr. Effron, results in annual amortization of \$3,241,000 and \$438,000, respectively. *Id.* at 15-16.

Mr. Effron testified that based on the above calculations, the annual Merger savings, net of costs to achieve, that should be reflected in the Gas Companies' next rate cases are \$18,222,000 applicable to Peoples Gas and \$2,611,000 applicable to North Shore. He stated that if the proposed transaction is approved and the Gas Companies file rate cases shortly after the approval, then these annual net Merger savings should be credited to their revenue requirements in those rate cases. Mr. Effron noted that he did not offset the pre-Merger initiatives in quantifying the proposed credits for Merger savings because these savings would not be reflected in the historic test year cost of service prior to any adjustment for Merger savings. Mr. Effron noted, however, that if the pre-Merger savings were implicitly reflected in pro forma adjustments to test year expenses, then the credits for merger savings should be reduced accordingly. In these circumstances, as shown on his Schedule DJE-2, he calculated the credit for Merger savings net of pre-Merger initiatives as \$17,660,000 for Peoples Gas and \$2,531,000 for North Shore. *Id.* at 16-17.

3. Staff's Position

Staff witness Bonita Pearce testified that she did not object to the allocation of synergy savings resulting from the Merger according to the terms and provisions of the affiliated interest agreements, including the STA, that will govern the provision and receipt of services among the affiliated companies subsequent to the closing of the proposed Reorganization. She recommends that the Commission's Order conclude that the allocation of savings resulting from the proposed Reorganization will be according to the terms and provisions of the affiliated interest agreements that will govern the provision and receipt of services among affiliated companies subsequent to the proposed Reorganization as approved by the Commission in this proceeding. Staff Ex. 2.0 (Corrected) at 27, 36.

Staff did not take issue with Applicants' proposal not to include any Merger-related savings or costs in the rate cases that the Gas Companies will file in early 2007. Additionally, Ms. Pearce testified that Staff did not object to Applicants' proposal to amortize and recover the regulatory asset recorded for costs to achieve over a four-year period starting in 2010. Staff Ex. 2.0 (Corrected) at 25-26. But, Ms. Pearce took issue with certain aspects of Applicants' proposal for recovery of merger-related costs. She reviewed each of the categories of Merger-related costs for which the Applicants requested deferral and recovery in the Gas Companies' rates and concluded that the majority of these costs appear to be necessary to generate the synergy savings that will result from the Reorganization. She proposed, however, that Applicants' proposal for recovery of two categories of these costs should be rejected in whole or in part. Specifically, she recommended that none of the Internal/External Communications costs, and only 50% of the Regulatory Process costs, should be recovered. She stated that these costs do not relate to normal operations of the type that would be reflected in a test year, but instead are required to effect the proposed Reorganization, include

costs that relate directly to shareholders, and do not generate synergy savings. She recommended that 50% of the Regulatory Process costs be disallowed because some portion of these costs appear to be directly related to shareholder activity. *Id.* at 8-21.

In her rebuttal testimony, Ms. Pearce proposed that the individual categories of Merger costs be grouped into three categories and that the Gas Companies be allowed to recover no more than the sum of the individual categories of costs in each group. Staff Ex. 8.0. The maximum recoverable amounts, that she testified could be recovered in each group, reflected her proposed disallowance of the Communications costs and of 50% of the Regulatory Process costs. The three categories of costs she proposed, and the maximum recoverable amounts in each group, were as follows:

- i. Separation Costs, Retention Costs and Relocation Costs: \$9,699,000.
- ii. System Integration Costs: \$28,038,000.
- iii. D&O Liability Tail Coverage, Regulatory Process, Facilities Integration, Internal/External Communication Costs and Integration Costs: \$5,519,000.

Ms. Pearce stated that this design would amount to up to \$43,256,000 of total costs to achieve being eligible for cost recovery. She stated that by defining eligible costs in accordance with these three groups, Applicants would be provided additional flexibility to spend and recover costs in the most efficient and beneficial manner for individual cost categories that vary from current estimates. Staff Ex. 8.0 at 13-16.

Ms. Pearce also objected to Applicants' proposal to record carrying costs on the unamortized portion of the regulatory asset recorded for costs to achieve. She stated that both ratepayers and shareholders would benefit from the synergy savings produced by the Merger, and that ratepayers would reimburse shareholders for the costs incurred to produce the savings through amortization of the regulatory asset over the four-year period 2010-2013. She stated that since ratepayers would repay the costs incurred to achieve the synergy savings, it was reasonable for shareholders to bear the financing costs. Accordingly, she recommended that the regulatory asset should not be included in rate base. Staff Ex. 2.0 (Corrected) at 23-25, 38.

In rebuttal testimony, Ms. Pearce noted that the Commission has not allowed recovery of carrying charges on deferred merger costs in any prior reorganization proceeding. She explained that the only proceeding she is aware of, in which the Commission allowed recovery of certain costs to achieve the merger, is the Ameren Corporation and Illinois Power Company merger, i.e., Docket 04-0294, and, in that proceeding, the petitioners did not seek to recover carrying charges. She also observed that under Applicants' proposed rate plan, Applicants do not reflect Merger savings or costs to achieve in rates until 2010 and thus, Applicants retain the net Merger savings (i.e., net of actual costs to achieve) that actually occur during the first three years after the merger closes. Ms. Pearce stated that she does not accept Applicants' proposal to disallow only the portion of carrying charges related to Merger costs accumulated during

the period 2007 through 2009, because Applicants' estimates show shareholders will be fully reimbursed for the Merger costs they incur, including financing cost, through retention of the net Merger savings until 2010. Ms. Pearce also observed that if the rates reflecting the amortization of the regulatory asset in 2010 are in effect longer than the underlying amortization period, shareholders could, all other things being equal, recover some of the financing costs by effectively over-recovering the costs to achieve the synergy savings. Staff Ex. 8.0 at 16-22.

Ms. Pearce recommends that the Commission impose requirements in connection with the creation of the regulatory asset for the Merger-related costs and the recovery of those costs, as follows:

- 1) Applicants would record all actual costs related to the reorganization as the costs were incurred;
- 2) Applicants would submit an annual report to the Commission with a copy to the Manager of Accounting by March 15th for the years 2006-2009 that would set forth:
 - i) A cost summary of the actual costs incurred to date, and
 - ii) A listing of each cost incurred in the calendar year that includes a description of the cost, the amount allocated to each utility by ICC account number, and a reference to a supporting document;
- 3) Applicants shall support the requested regulatory asset during the anticipated proceeding to set rates for the post-2009 period by
 - a) Providing for the record the following
 - i) A cost summary of the actual costs incurred and
 - ii) A listing of the actual costs incurred that includes a description of each cost, the amount, and a reference to a supporting document; and
 - b) Making the supporting documents available for review by the parties in the proceeding; and
- 4) Applicants shall have the burden of proof to demonstrate that the Applicants have incurred actual costs underlying the requested regulatory asset in accordance with the recoverable cost categories and maximum amounts approved by the Commission; and
- 5) Remaining costs outside of the recoverable cost categories or in excess of the maximum cost category amounts approved by the Commission in this

proceeding, if any, shall be excluded from rate recovery in any other rate proceeding.

Staff Ex. 8.0 at lines 476-508.

As noted in Section IV.B.1 of this Order, above, Applicants agreed to Staff's proposed requirements. Their agreement with these requirements is also memorialized in the MOA, as indicated in Section IV.B.4, below.

Staff witness Ms. Pearce filed supplemental direct testimony based on her review of the CTA Agreement submitted with the additional testimony of Applicants' witness Ms. Ford. She testified that the CTA Agreement formalizes the use of the allocation percentages for Merger costs that were presented in the direct testimony of Applicants' witness Mr. Flaherty. She testified that, so long as Applicants accepted her proposed condition listed as (3) in the immediately preceding paragraph, she took no exception to the CTA Agreement. Staff Ex. 6.0 at 5-6.

4. Resolution of Issues in Joint Parties Exhibit 1

The MOA, Joint Parties Exhibit 1, includes provisions to resolve the contested issues among Applicants, Staff, and certain intervenors, concerning the determination of the allocation and recovery of merger-related savings and costs pursuant to Section 7-204(c). Specifically, the MOA provides as follows:

Inclusion of Synergy Savings and Costs to Achieve in Customer Rates

1. In the rate cases to be filed by Peoples Gas and North Shore in 2007, the companies will use historical test years ended September 30, 2006, with adjustments for "known and measurable changes" through September 30, 2007. There will be adjustments for "known and measurable changes" for merger-related synergy savings of \$11,445,400 for Peoples Gas and \$1,633,000 for North Shore. (The foregoing does not include gas cost savings, if any, which would flow through the Peoples Gas and North Shore Purchased Gas Adjustment clauses.)
2. Peoples Gas' and North Shore's recovery of merger-related costs to achieve will be limited to the percentage allocations of the total costs to achieve specified in Appendix A to the Cost-to-Achieve Allocation Agreement and the total amount of the cost recovery will be capped at \$44,922,750. Additionally, the individual categories of merger-related costs to achieve will be placed into the following three groups with the total amount of cost recovery in each group capped as follows:
 - i. Separation Costs, Retention Costs and Relocation Costs: \$9,699,000.

- ii. System Integration Costs: \$28,038,000
- iii. D&O Liability Tail Coverage, Regulatory Process, Facilities Integration, Internal/External Communication Costs and Integration Costs: \$7,185,750.

Other than the cap of \$28,038,000 on System Integration Costs, there will be no caps or pre-determined disallowances in the individual categories of merger-related costs to achieve in each of the groups identified in (i) and (iii) above.

The Commission's order in this ICC Docket 06-0540 will provide that the determinations that Regulatory Process Costs and Internal and External Communications Costs are eligible for recovery from ratepayers was based upon the unique circumstances of this case, including the resolution of contested issues regarding recovery of costs to achieve, and shall have no precedential effect in future merger cases.

- 3. The amortization period for the regulatory asset for Peoples Gas' and North Shore's allocated shares of merger-related costs will be five years, commencing on the date rates go into effect incorporating the amortization of specific costs. Therefore, the 5-year amortization of the total of \$35,116,750 of merger-related costs to be included in the 2007 rate case orders (see point 4 below) will commence on the date rates go into effect pursuant to the 2007 rate case orders. The balance of merger-related costs incurred (not to exceed \$9,806,000 per point 2 above) will be amortized over 5 years beginning on January 1, 2010 or the month following expenditure, whichever is later, using a five-year amortization period.
- 4. The 2007 rate case orders will provide for the amortization of the following amounts of merger-related costs over five years commencing on the effective date of the rates approved by the 2007 rate case orders: \$30,948,040 for Peoples Gas (resulting in an annual amortization of \$6,189,608) and \$4,168,710 for North Shore (resulting in an annual amortization of \$833,742). Peoples Gas and North Shore will provide evidence in their direct case filings to show the amounts of these merger-related costs in each category of costs and the allocations to each utility, summing to the \$30,948,040 and \$4,168,710 amounts. It is recognized that the full amounts of \$30,948,040 and \$4,168,710 may not have been actually incurred by the time the record closes in the 2007 rate cases.
- 5. In any future rate cases to be filed in which Peoples Gas and North Shore are seeking recovery of merger costs, Peoples Gas and North Shore will present evidence showing the total amounts of merger-related costs

actually incurred in each category and the amounts allocated to Peoples Gas and North Shore in accordance with the established allocation percentages, and that the cumulative synergy savings exceed the total costs to achieve being recovered.

6. Applicants accept and will comply with the requirements listed by Staff witness Bonita A. Pearce at lines 476-508 of Staff Exhibit 8.0.
7. Carrying costs on the merger-related costs will not be recorded in the regulatory asset, and the unamortized balance of the regulatory asset will not be included in rate base. As a result, Peoples Gas and North Shore will not recover carrying costs on the merger-related costs from ratepayers.

5. Commission Analysis and Conclusion

On the entirety of the record evidence, the Commission finds that the agreements of the parties and the commitments of Applicants set forth in the MOA (as quoted in Section IV.B.4 above) appropriately and fully resolve the contested issues in this case under Section 7-204(c) of the PUA. These shall be adopted as conditions to the Commission's approval of the Reorganization and included in Appendix A to this Order. See Appendix A (Conditions 13-21). The agreements and conditions in the MOA (quoted in Section IV.B.4 above) reasonably provide for the allocation of savings resulting from the proposed Merger, and identify the amount of costs incurred by Applicants in accomplishing the proposed Reorganization that the Gas Companies should be allowed to recover through their rates, and outline the specific means of recovery. Additionally, as set forth in point 6 (quoted from the MOA and set out in Section IV.B.4 above), the Applicants shall comply with the requirements proposed by Staff witness Ms. Pearce at lines 476-508 of Staff Exhibit 8.0. The determinations made in this Order, that Regulatory Process costs and Internal and External Communications costs are eligible for recovery from ratepayers, is based upon the unique circumstances of this case, that includes the resolution as set out in the MOA of contested issues regarding recovery of costs to achieve, and shall have no precedent value in future merger cases. The Commission also concludes that the allocation of savings resulting from the proposed Reorganization should be according to the terms and provisions of the affiliated interest agreements that will govern the provision and receipt of services among affiliated companies subsequent to the proposed Reorganization as approved by the Commission in this Order. Finally, the Commission concludes that the allocation factors set forth on Appendix A of the CTA Agreement, should be used to allocate the Merger-related costs to Peoples Gas and North Shore for purposes of determining the merger-related costs that may be recovered by the Gas Companies pursuant to the provisions of the MOA that are hereby being adopted as conditions of approval.

C. Other Conditions under Section 7-204(f) Proposed by Staff

In addition to the conditions of approval adopted herein and as discussed in Sections IV.A and IV.B above, Staff witness Dr. Rearden suggests that certain other conditions be imposed on the Commission's approval of the Reorganization. Specifically, he proposed that: (1) the Commission should be allowed access to all the books and records of the services company to be formed by the merged entity; and (2) the merged company should be required to send a notice to the Commission of all filings by any subsidiary of the merged entity with either FERC or the PSCW. Staff Ex. 5.0 at 12-14.

Applicants' witness Mr. Schott testified that Applicants agree to Dr. Rearden's first proposed condition. Applicants' Ex. JFS-2.0 at 26. This agreement was confirmed in Applicants' Exhibit JFS-7.0, which states that: "The Applicants agree, regardless of the requirements of the Illinois Public Utilities Act, to provide access to all books and records of the service company for all transactions by the service company to the Illinois Commerce Commission and its Staff." With respect to Dr. Rearden's second proposed condition, Applicants commit to provide notice to Staff of any gas-related filing submitted to FERC by, or on behalf of, the regulated gas utility subsidiaries of the combined company, and to provide Staff a copy of the combined company's annual holding company filings that are submitted to the PSCW, the FERC, the Michigan Public Service Commission and the Minnesota Public Utilities Commission. Applicants' Ex. JFS-2.0 at 27. Additionally, Applicants made the following commitment as set forth in Applicants' Exhibit JFS-6.0:

By the 10th of each month commencing the second month after the closing of the Reorganization, Applicants shall file on the Commission's e-Docket system in Docket 06-0540 a notice identifying all filings by any subsidiary of WPS Resources with the PSCW during the prior month. Applicants shall also serve a copy of each monthly notice on the Commission's Policy Manager in the Energy Division and the Manager of Accounting.

The Commission concludes that the conditions, agreed to by Applicants and set out in the above paragraph, are appropriate. These are hereby adopted as conditions to our approval of the Reorganization and are being included in Appendix A to this Order. See Appendix A (Conditions 37-39).

D. Applicants' Request for a Finding Under Section 7-204(f) Relating to Tax Consequences of LIFO Gas in Storage as of the Closing Date

Applicants request that, if the Merger does not close on or shortly after January 1, 2007 and the Gas Companies are not able to mitigate higher tax liability resulting from the tax consequences of the Gas Companies' LIFO gas storage inventories, the Gas Companies may reflect in future rate proceedings the revenue requirement impacts of increased rate base caused by the recognition for tax purposes of a temporary

reduction in LIFO gas in storage inventory as of the closing date. Application at 22. Applicants state that, because the Reorganization will trigger a year-end for tax purposes, PEC will need to file a tax return and the Gas Companies will need to take gas in storage inventories as of the closing date. Applicants explain that if the closing date occurs when gas in storage inventories are low (which is increasingly likely from January through March), the cost used to price withdrawals and the cost of gas sold for tax purposes will be the historically lower cost of gas due to the temporary reduction in LIFO inventory. The decrease in the cost of gas sold, they assert, will result in higher taxable income and therefore a higher income tax liability. The Applicants further state that because the Reorganization does not cause a year-end for financial accounting purposes, the cost of gas sold for financial reporting purposes will not reflect the recognition for tax purposes of the temporary reduction in LIFO inventory. Applicants state that the resulting book-to-tax difference in cost of gas sold will result in the recognition of a deferred tax asset that decreases the accumulated provision for deferred income taxes and increases rate base, and therefore rates, in future rate proceedings. Application at 21-22; Applicants' Ex. JFS-1.0 at 9-11.

Applicants' requested finding was opposed by Staff witness Ms. Hathorn and AG-CUB-City witness Mr. Efron. Ms. Hathorn notes that the projected rate base impact of the LIFO tax issue ranged from a low of \$0 if closing occurred on January 1, 2007, increasing to a high of \$71.6 million if closing occurred on March 31, 2007, and then declining to a low of \$0 if closing occurred on September 30, 2007. She states that while Applicants must obtain regulatory approvals to close the Merger, it is the Applicants who determine when closing takes place after all approvals are received. She also stated that the receipt of regulatory approvals is a function of when Applicants filed the requests for approvals. She further testified that if this Commission issued its order approving the Reorganization by January 1, 2007, the need for other approvals could still delay the closing. Staff Ex. 1.0 at 12-18. Mr. Efron testified that the timing of the application for approval of the Merger was completely within Applicants' control, and that if the Applicants' chose to file the Application at a point such that the necessary investigation could not be completed in time to allow a decision by January 1, 2007, the costs incurred as a result of the Merger closing after that date should not be imposed on the Gas Companies' ratepayers. GCI Ex. 1.0 at 22.

In the course of this proceeding, Applicants developed a plan that would substantially reduce the risk of adverse tax consequences of closing the Merger, as related to the LIFO gas in storage inventories, and at little or no cost. A description of this plan was provided by Applicants during discovery, and entered into the record as Exhibit A to Staff witness Ms. Hathorn's rebuttal testimony. Staff Ex. 7.0. Applicants' witness Mr. Schott testified that the key component of this strategy is for PEC and its subsidiaries to change their fiscal year from one ending on September 30 to one ending on December 31, and for this change to become effective on December 31, 2006. Applicants' Ex. JFS-3.0 at 4.

The MOA, Joint Parties Exhibit 1, contains the following provision relating to this issue:

LIFO-Gas Storage Deferred Tax Impact

To the extent the closing of the reorganization, which is the subject of ICC Docket 06-0540, is delayed after January 1, 2007, Applicants will not include in future rate proceedings the revenue requirement impacts of increased rate base caused by the recognition for tax purposes of a temporary reduction in LIFO gas in storage inventory as of the closing date, but will take actions to mitigate the tax impact of the LIFO issue. Such actions will not affect the gas supply plan of the utilities and will have no impact on customers' rates.

Finding the agreed-to resolution to be reasonable, the Commission is including this provision as one of the conditions of approval in Appendix A to this Order. See Appendix A (Condition 1). Given the nature of this condition, however, we understand that Applicants' request for a finding pursuant to Section 7-204(f) relating to future rate base treatment of a deferred tax asset that could be created as a result of the tax consequences of closing the merger and the Gas Companies' LIFO gas storage inventories, is effectively withdrawn. As such, no definitive ruling on the issue is required by the Commission.

E. Approval of Accounting Entries

Applicants request a finding by the Commission, pursuant to Section 7-204(f) of the PUA, that any adjustments to the Gas Companies' books for financial reporting purposes resulting from application of purchase or "push down" accounting for the Reorganization, will be disregarded for regulatory reporting purposes and for ratemaking purposes. Applicants state that the most notable adjustments in this regard relate to the Gas Companies' pension and post-retirement benefits obligations. Applicants state that as a result of the "fresh start" accounting defined by Statement of Financial Accounting Standards ("SFAS") 87 and 106, the accounting standards that specify the requirements related to accounting for pension and other post-employment benefits ("OPEB") costs, Peoples Gas and North Shore will record a net liability related to pension and other post-employment benefit costs of \$56.2 million at June 30, 2006 (\$34.1 million for Peoples Gas and \$22.1 million for North Shore) as a result of the Merger. As of June 30, Peoples Gas and North Shore would have recorded on their books a net asset related to these items of \$88.5 million (\$99.0 million asset for Peoples Gas and \$10.5 million liability for North Shore). Applicants state that the difference of \$144.7 million (\$133.1 million for Peoples Gas and \$11.6 million for North Shore) represents costs experienced by the Gas Companies prior to the Merger, including experience losses, prior service costs, and transition costs, that have been incurred and deferred based on the requirements of SFAS 87 and 106. Applicants state that based on the requirements of SFAS 87 and 106 these items are deferred and amortized to expense over time. Application at 20.

Applicants' witness Mr. Johnson explained these accounting impacts in his direct testimony. Applicants' Ex. BAJ-1.0 at 6-8. He testified that under purchase accounting, an amount of goodwill, representing the amount of consideration paid in a transaction that cannot be specifically assigned to identifiable assets or liabilities, would be assigned to the Gas Companies as a result of the Merger. He stated that Applicants were proposing that these impacts not apply for regulatory reporting purposes or in future rate-setting proceedings. According to Mr. Johnson, Applicants were proposing that the Gas Companies' future rate filings will not reflect the income statement and balance sheet effects of the push down accounting and their rates will be set as if they had continued to follow their historic accounting practices with respect to the items impacted by push down accounting. He stated that this approach will allow pension and OPEB expenses to be reflected in rates consistent with the levels that would have been recorded without these push down adjustments. He further explained that the Gas Companies' regulatory reports to the Commission would be presented without these impacts of push-down accounting. Mr. Johnson testified that Applicants' proposed approach was reasonable because it will preserve the Gas Companies' ability to recover reasonable costs they have incurred in providing service. He pointed out that the proposed treatment is consistent with the treatment ordered by the Commission, in its order in Docket 04-0294, that approved the acquisition of Illinois Power Company by Ameren Corporation. Finally, Mr. Johnson stated that for future rate-setting proceedings, the goodwill asset and related equity balance on the Gas Companies' financial statements will be disregarded in the development of their cost of service; this will result in a lower common equity ratio in the development of the cost of capital than if this portion of the common equity balance was included.

In her direct testimony, Staff witness Pearce addressed Applicants' proposal to ignore the effects of purchase accounting on the Gas Companies for regulatory reporting and rate-setting purposes. She reviewed the relevant accounting principles under generally accepted accounting principles ("GAAP") and the Commission's USOA and the principal areas of impact that purchase accounting would have on the Gas Companies' books as described by Mr. Johnson. Staff Ex. 2.0 (Corrected) at 29-34. Given that the Applicants are required to use push-down accounting for financial reporting purposes and have requested to reverse the effects of push-down accounting for regulatory ratemaking purposes, Ms. Pearce did not object to the Applicants' use of push down accounting to record the acquisition of the Gas Companies, assuming this request is reflected as a condition of approval in the Order. *Id.* at 34.

In his direct testimony, AG-CUB-City witness Mr. Effron also reviewed the Applicants' proposals with respect to the treatment for regulatory purposes of the impacts of accounting for goodwill and purchase accounting on the Gas Companies' books. He agreed that the Applicants' proposals, as described above, were appropriate. GCI Ex. 1.0 at 17-20. With respect to the Applicants' proposal to address the restatement of the pension and postretirement benefits other than pensions ("PBOP") recorded on the balance sheets of the Gas Companies for ratemaking purposes, however, Mr. Effron testified that the Gas Companies should be required to verify that the proposed accounting treatment accomplishes its stated goal in future rate

cases. That is, the recording of the pension and PBOP regulatory asset should not increase the Gas Companies' revenue requirement above what it would be in the absence of the Merger. For example, he stated, if the amortization of the regulatory asset is included in operating expenses, then the Gas Companies should be required to verify the amortization does not result in the pension and PBOP expense being greater than it would have been in the absence of the merger. *Id.*

Upon our review, the Commission concludes that Applicants' proposal, i.e., that any adjustments to the Gas Companies' books for financial reporting purposes resulting from application of purchase accounting for the Reorganization be disregarded for regulatory reporting purposes and for ratemaking purposes, is appropriate and should be adopted. This approval includes the Applicants' proposed treatment, for regulatory rate-setting purposes, of good will recorded on the Gas Companies' books as a result of the transaction, and as described by Applicants' witness Mr. Johnson. A condition reflecting approval of this proposal is being included in Appendix A to this Order See Appendix A (Condition 2).

F. Proposed Finding Relating to Purchase Accounting

In a related request, Applicants seek approval of the proposed accounting entries associated with the Reorganization that were provided as Attachment C to the Application and as Applicants' Exhibit DLF-1.2 sponsored by Ms. Ford. These entries include the entries to record the effect of purchase accounting on the books of Peoples Gas and North Shore. Staff witness Ms. Pearce testified, however, that the Commission could not approve these entries because they were entries to record the effects of the transaction for external financial reporting purposes, not in accordance with the USOA. Staff Ex. 2.0 (Corrected) at 28-29. Ms. Pearce recommends that the Gas Companies be required to file with the Chief Clerk of the Commission, and provide a copy to the Manager of Accounting, copies of the final accounting entries to be recorded on the regulatory books, including the actual amounts recorded by the Gas Companies, within six months following the closing. *Id.* at 38. In her rebuttal testimony, Applicants' witness Ms. Kallas stated that Applicants accept this condition with one modification, i.e., that Applicants would file copies of the accounting entries and preliminary amounts within 6 months after closing and provide the final entries and amounts no later than 12 months after closing. She explained that, under GAAP, the combined company will not be required to finalize the purchase accounting valuations and entries until 12 months after the Merger closes. Applicants' Ex. LK-2.0 at 4-5. Staff witness Ms. Pearce agreed with this modification to her proposed condition. Staff Ex. 8.0 at 3-4.

Having considered the relevant evidence, the Commission concludes that Applicants are required to file with the Chief Clerk of the Commission and provide, to the Manager of Accounting, copies of the accounting entries to be recorded on the regulatory books of the Gas Companies, including preliminary amounts to be recorded, within six months following the closing, and to file the final entries and amounts no later than 12 months after closing, as stated by Applicant witness Kallas and agreed to by

Staff witness Pearce. This requirement is being included in Appendix A to this Order as a condition to approval of the Reorganization. (Condition 3).

G. Approval Under Section 7-102 of the PUA

In the Application, Applicants refer to Section 7-102 of the PUA which requires Commission approval whenever a “public utility may by any means, direct or indirect, merge or consolidate its franchises, licenses, permits, plants, equipment, business or other property with that of any other public utility”, Section 7-102(A)(d). It also requires Commission approval for a public utility to “assign, transfer, lease, mortgage, sell (by option or otherwise), or otherwise dispose of or encumber the whole or any part of its franchises, licenses, permits, plant, equipment, business, or other property . . .” Section 7-102(A)(c). Applicants note, however, that Section 7-204(e) expressly states that “[n]o other Commission approvals shall be required for mergers that are subject to this Section.” Applicants state that they do not believe that either Section 7-102(A)(c) or (d) apply to the Reorganization, because the Reorganization does not involve a direct or indirect merger or consolidation of a utility’s business or property and is not a sale or disposition of a utility’s business or property, but rather is a change in control transaction subject to Sections 7-204 and 7-204A of the PUA. In any event, Applicants state that if the Commission were to determine that the Reorganization is also subject to Section 7-102, the information submitted in support of the Application is sufficient to meet the requirements of Section 7-102, so that any approval deemed necessary pursuant to Section 7-102 should be granted. Application at 29.

The Commission concludes that the findings it is making pursuant to Section 7-204 of the PUA and the conditions to approval set forth in Appendix A to this Order are sufficient to support a conclusion that approval for the Reorganization should reasonably be granted; that the Reorganization is in the public interest; and, that the public will be inconvenienced thereby. This is the standard for approval set forth in Section 7-102. 220 ILCS 5/7-102. Therefore, if, and to the extent that, Section 7-102 is applicable to the proposed Reorganization, the instant record shows that the criteria for approval under Section 7-102 have been met.

H. Request for Approval of Agreements with Affiliated Interests Under Sections 7-101 and 7-204A(b) of the PUA

In the course of this proceeding, Applicants requested approval for the Gas Companies to enter into two agreements with affiliated interests. These are: (1) the WPS Resources Regulated AIA (Applicants’ Ex. DLF-1.2); and (2) the STA, as revised and presented as Applicants’ Exhibit LK-1.2. Both the Regulated AIA and the STA, and the evidence concerning these proposed agreements, are discussed at length in Sections IV.A.2 and IV.A.3 of this Order, when addressing the requirements of Section 7-204(b)(2) and (3) of the PUA. For the reasons discussed in those sections of this Order, the Commission concludes that execution and performance of the Regulated AIA

and the STA by Peoples Gas and North Shore should be approved, pursuant to Section 7-101 of the PUA. This approval is subject to the reporting requirements and other conditions adopted by the Commission as discussed in Sections IV.A.2 and 3 of this Order and set forth in Appendix A hereto (Conditions 4-11).

I. Request for Approval of Tariff Changes to Change Reconciliation Years in the Gas Companies' Riders 2 and 11 to Calendar Year Bases

Applicants request approval, pursuant to Sections 9-201 and 9-220 of the PUA (220 ILCS 5/9-201 and 9-220) and 83 Illinois Administrative Code Part 525, to change the reconciliation years in the Gas Companies' Gas Charge tariffs (Rider 2) and Environmental Activities tariffs (Rider 11), from the 12 months ending September 30 to the 12 months ending December 31, in order to match the fiscal years used by WPS Resources and all its subsidiaries. Applicants state that PEC and the Gas Companies will be changing their fiscal years for financial reporting purposes to a calendar year basis. Application at 32-33. Applicants presented proposed revised tariff sheets as Exhibits VG-1.1 through VG-1.4 sponsored by Applicants' witness Ms. Grace. With respect to transitioning from a fiscal year to a calendar year reconciliation period for Rider 2, Gas Charge, Applicants request the Commission to specify that it will initiate a separate reconciliation proceeding for the resulting three-month period ending December 31, 2006. With respect to transitioning from a fiscal year to a calendar year reconciliation period for Rider 11, Adjustment for Incremental Costs of Environmental Activities, Applicants propose a 15-month reporting period of October 1, 2006 through December 31, 2007. Applicants' Ex. VG-1.0 at 3-4.

Staff witness Ms. Hathhorn reviewed the Gas Companies' proposed tariff changes to Rider 2 and Rider 11. She found no basis to disagree with the proposed language for Rider 2 to change the year end from September 30 to December 31. She recommends that the Commission state in this Order that it will implement a separate reconciliation proceeding under Section 9-220 to address the three-month period October 1, 2006 through December 31, 2006. Ms. Hathhorn recommends that the following language be added to the Gas Companies' Rider 11 tariffs: "For the fiscal year ended December 31, 2007, pursuant to the Commission's order in Docket 06-0540, the Commission may conduct this review for the five quarters beginning October 1, 2006 and ending December 31, 2007." Applicants agreed to this additional language. Staff Ex. 1.0 at 19.

The Commission concludes that the Gas Companies' proposed revisions to their Rider 2 and Rider 11 tariffs (with the additional text for the Rider 11 tariffs proposed by Ms. Hathhorn and accepted by Applicants) should be approved and that the Gas Companies should be directed to file the revised tariff sheets approved herein as compliance filings, with the revised tariff sheets to be effective on the date of closing of the Reorganization. With respect to the Gas Companies' Gas Charge tariffs, Rider 2, the Commission will implement a separate reconciliation proceeding for each Gas

Company under Section 9-220 to address the three-month period October 1, 2006 through December 31, 2006.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Peoples Gas and North Shore are Illinois corporations that are engaged in the distribution of natural gas to the public at retail in this State; Peoples Gas and North Shore is each a “public utility” as that term is defined in Section 3-105 of the PUA, 220 ILCS 5/3-105;
- (2) the Commission has jurisdiction over the parties hereto and the subject matter herein;
- (3) the recitals of fact set forth in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;
- (4) pursuant to Section 7-204 of the PUA, and subject to the conditions of approval set forth in Appendix A to this Order, the Commission finds that:
 - (A) the proposed Reorganization will not diminish the ability of Peoples Gas and North Shore to provide adequate, reliable, efficient, safe and least-cost public utility service;
 - (B) the proposed Reorganization will not result in the unjustified subsidization of non-utility activities by Peoples Gas or North Shore or their customers;
 - (C) costs and facilities will be fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by Peoples Gas and North Shore for ratemaking purposes;
 - (D) the proposed Reorganization will not impair the ability of Peoples Gas and North Shore to raise necessary capital on reasonable terms or to maintain reasonable capital structures;
 - (E) Peoples Gas and North Shore will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;

- (F) the proposed Reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and
 - (G) the proposed Reorganization is not likely to result in any adverse rate impacts on the retail customers of Peoples Gas and North Shore;
- (5) savings resulting from the proposed Reorganization shall be allocated in the manner set forth in Section IV.B.5 of this Order; the amounts of costs incurred in accomplishing the proposed Reorganization that Peoples Gas and North Shore shall be allowed to recover and how such costs will be allocated shall be in accordance with the conclusions in Section IV.B.5 of this Order;
 - (6) subject to written acceptance by WPS Resources, PEC, Peoples Gas and North Shore of the conditions set forth in Appendix A to this Order, Applicants' request for approval under Section 7-204 of the PUA and, to the extent necessary, Section 7-102 of the PUA, for Peoples Gas and North Shore to engage in a Reorganization pursuant to which WPS Resources will become the direct owner of 100% of the common stock of PEC and the indirect owner of 100% of the common stock of Peoples Gas and North Shore, as more fully described in the Application, should be granted;
 - (7) Peoples Gas and North Shore should be authorized to defer and record as a regulatory asset costs incurred in implementing the Reorganization, in amounts not to exceed, in the aggregate for both Gas Companies, (i) \$9,699,000 for Separation Costs, Retention Costs and Relocation Costs, (ii) \$28,038,000 for System Integration Costs, and (iii) \$7,185,750 for D&O Liability Tail Coverage Costs, Regulatory Process Costs, Facilities Integration Costs, Internal/External Communications Costs and Integration Costs, and to amortize such costs ratably over a five-year period, with such costs to be allocated to Peoples Gas and North Shore in accordance with the CTA Agreement, Applicants' Exhibit DLF-1.4 and the allocation percentages set forth in Appendix A thereto; this authorization is conditioned on and in all respects subject to Conditions 14 through 21 in Appendix A to this Order;
 - (8) consent and approval, pursuant to Section 7-101 of the PUA, to the entry by Peoples Gas and North Shore into the WPS Resources Regulated AIA and the Services and Transfers Agreement, submitted in evidence as Applicants' Exhibits DLF-1.1 and LK-1.2, respectively, should be granted, subject in all respects to Conditions 5 through 9 and 11 in Appendix A to this Order;

- (9) at the closing of the Reorganization, the agreement among PEC, Peoples Gas, North Shore and Peoples Development, Inc., for the provision of services by any one of them to the other, dated July 17, 1969, and the Personal Property Transfer Agreement among PEC, Peoples Gas and North Shore dated December 22, 1975, should be terminated and of no further force and effect except as to transactions completed or in progress as of the effective date of the STA;
- (10) Peoples Gas and North Shore should be authorized to file the proposed revised tariff sheets for their respective Rider 2, Gas Charge, tariffs as set forth in Applicants' Exhibits VG-1.1 and VG-1.2, as compliance filings, with such revised tariffs to be effective on the date of closing of the Reorganization; following the closing of the Reorganization, the Commission, will implement a separate reconciliation proceeding for each Gas Company under Section 9-220 to address the three-month period October 1, 2006 through December 31, 2006;
- (11) Peoples Gas and North Shore should be authorized to file the proposed revised tariff sheets for their respective Rider 11, Adjustment for Incremental Costs of Environmental Activities, tariffs as set forth in Applicants' Exhibits VG-1.3 and VG-1.4 and as revised as described in Section IV.H of this Order, as compliance filings, with such revised tariffs to be effective on the date of closing of the Reorganization;
- (12) each of the authorizations granted to Applicants in this Order is expressly conditioned on the receipt by the Commission of verified statements signed by officers of each Applicant stating the acceptance by each of the Applicants of the conditions set forth in Appendix A to this Order; such verified statements shall be filed with the Chief Clerk of the Commission no later than two business days prior to the closing of the Reorganization; and
- (13) any objections, motions, or petitions filed in this proceedings that remain unresolved should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that, subject to written acceptance in accordance with Finding (12) by WPS Resources Corporation, Peoples Energy Corporation, The Peoples Gas Light and Coke Company and North Shore Gas Company of the conditions set forth in Appendix A to this Order, Applicants' request for approval under Section 7-204 of the PUA and, to the extent necessary, Section 7-102 of the PUA, for Peoples Gas and North Shore to engage in a Reorganization pursuant to which WPS Resources will become the direct owner of 100% of the common stock of PEC and the indirect owner of 100% of the common stock of Peoples Gas and North Shore, as more fully described in the Application, shall be, and is hereby, granted.

IT IS FURTHER ORDERED that Peoples Gas and North Shore shall be, and hereby are, authorized to defer and record as a regulatory asset costs incurred in implementing the Reorganization, in amounts not to exceed, in the aggregate for both Gas Companies, (i) \$9,699,000 for Separation Costs, Retention Costs and Relocation Costs, (ii) \$28,038,000 for System Integration Costs, and (iii) \$7,185,750 for D&O Liability Tail Coverage Costs, Regulatory Process Costs, Facilities Integration Costs, Internal/External Communications Costs and Integration Costs, and to amortize such costs ratably over a five-year period, with such costs to be allocated to Peoples Gas and North Shore in accordance with the CTA Agreement, Applicants' Exhibit DLF-1.4 and the allocation percentages set forth in Appendix A thereto; this authorization is conditioned on and in all respects subject to Conditions 14 through 21 in Appendix A to this Order.

IT IS FURTHER ORDERED pursuant to Section 7-101 of the PUA that consent and approval to the entry by Peoples Gas and North Shore into the WPS Resources Regulated AIA and the Services and Transfers Agreement, submitted in evidence as Applicants' Exhibits DLF-1.1 and LK-1.2, respectively, should be granted, subject in all respects to Conditions 5 through 9 and 11 in Appendix A to this Order.

IT IS FURTHER ORDERED that at the closing of the Reorganization, the agreement among PEC, Peoples Gas, North Shore and Peoples Development, Inc., for the provision of services by any one of them to the other, dated July 17, 1969, and the Personal Property Transfer Agreement among PEC, Peoples Gas and North Shore dated December 22, 1975, shall be terminated and of no further force and effect except as to transactions completed or in progress as of the effective date of the STA.

IT IS FURTHER ORDERED that Peoples Gas and North Shore shall file the proposed revised tariff sheets for their respective Rider 2, Gas Charge, tariffs as set forth in Applicants' Exhibits VG-1.1 and VG-1.2, as compliance filings, with such revised tariffs to be effective on the date of closing of the Reorganization.

IT IS FURTHER ORDERED that following the closing of the Reorganization, the Commission will implement separate reconciliation proceedings under Section 9-220 of the PUA with respect to Peoples Gas' and North Shore's Rider 2, Gas Charge, tariffs to address the three-month period October 1, 2006 through December 31, 2006.

IT IS FURTHER ORDERED that Peoples Gas and North Shore shall file the proposed revised tariff sheets for their respective Rider 11, Adjustment for Incremental Costs of Environmental Activities, tariffs as set forth in Applicants' Exhibits VG-1.3 and VG-1.4 and as revised as described in Section IV.H of this Order, as compliance filings, with such revised tariffs to be effective on the date of closing of the Reorganization.

IT IS FURTHER ORDERED that any objections, motions or petitions filed in this proceeding that remain unresolved should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the PUA and 83 Illinois Administrative Code 200.880, this Order is final, it is not subject to the Administrative Review Law.

DATED:
BRIEFS ON EXCEPTION DUE:

January 23, 2007
January 25, 2007
By 12:00 Noon

Eve Moran and
Leslie Haynes,
Administrative Law Judges