

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

NORTH SHORE GAS COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	No. 07-0241
	:	and
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	No. 07-0242
	:	Consol.
	:	
Proposed General Increase In Rates For Gas Service.	:	

Surrebuttal Testimony of

**JAMES F. SCHOTT**

Vice President, Regulatory Affairs  
The Peoples Gas Light and Coke Company and  
North Shore Gas Company

On Behalf of  
The Peoples Gas Light and Coke Company and  
North Shore Gas Company

September 5, 2007

## TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Witness Identification	1
B. Purposes of Testimony	1
C. Summary of Conclusions	1
D. Itemized Attachments to Surrebuttal Testimony	2
II. PROPOSED RIDER ICR	2

1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 Q. Please state your name.

4 A. James F. Schott.

5 Q. Are you the same James F. Schott who submitted Direct and Rebuttal Testimony on  
6 behalf of The Peoples Gas Light and Coke Company (“Peoples Gas” or the “Company”)  
7 and North Shore Gas Company (“North Shore”) (together, “the Utilities”) in this  
8 consolidated Docket?

9 A. Yes.

10 **B. Purposes of Testimony**

11 Q. What are the purposes of your Surrebuttal Testimony in this proceeding?

12 A. The purpose of my Surrebuttal Testimony is to address certain alleged deficiencies of  
13 Peoples Gas’ revised Rider ICR proposal as modified by the concession to accept Illinois  
14 Commerce Commission Staff witness Ms. Hathhorn’s Rider QIP framework.

15 **C. Summary of Conclusions**

16 Q. Please summarize the conclusions of your Surrebuttal Testimony.

17 A. In brief, the conclusions of my Surrebuttal Testimony are as follows: (1) A return credit  
18 as proposed by Staff witness Ms. Hathhorn as an element of Rider ICR (Rider QIP) is  
19 inappropriate; (2) the Company is willing to further refine the definition of recoverable  
20 costs to address the concerns of certain parties; and (3) clarification of the support of the  
21 City of Chicago for Rider ICR is appropriate.

22 **D. Itemized Attachments to Surrebuttal Testimony**

23 Q. Are there any attachments to your Surrebuttal Testimony?

24 A. Yes, there are two. I am sponsoring a North Shore/Peoples Gas Ex. JFS-3.1, which is  
25 two maps showing the location of CI/DI main on the Peoples system. I'm also  
26 sponsoring a North Shore/Peoples Gas Ex. JFS-3.2, which is a supplemental response to  
27 Data Request No. AG-8.01 concerning leak repair savings.

28 **II. PROPOSED RIDER ICR**

29 Q. Has Peoples Gas agreed to modify its Rider ICR proposal?

30 A. Yes, it has. As I discussed in my Rebuttal Testimony, Peoples Gas agrees that Staff  
31 witness Ms. Hathhorn's modification to its Rider ICR with certain modifications.

32 Q. What are those modifications?

33 A. In a data response to Staff Data Request No. 24.01, the Company attached proposed tariff  
34 sheets which reflect the modifications the Company requires. Ms. Hathhorn includes  
35 these tariff sheets as Staff Ex. No. 13, Attachment D to her Rebuttal Testimony.

36 Q. Have parties addressed the Company's modifications in their Rebuttal Testimony?

37 A. Yes, they have. I will address the parties' comments in the discussion which follows.

38 Q. Ms. Hathhorn wishes to rename the Rider ICR as Rider QIP. Do you agree?

39 A. No, we believe it confuses the record to rename this rider at this point. We propose that  
40 the tariff submitted in response to Staff Data Request No. 24.01 be re-titled "Rider ICR".  
41 In my testimony, I will refer to Rider ICR.

42 Q. In lines 402-407 of Staff witness Ms. Hathhorn's Rebuttal Testimony, she criticizes the  
43 Company's position on the rate of return in Rider ICR. Do you have any comments on  
44 Ms. Hathhorn's position?

45 A. Yes, I do. Ms. Hathhorn correctly states that the Company opposes her proposal to  
46 include a rate of return credit in the proposed Rider ICR. Rider ICR was always intended  
47 to be a straightforward mechanism to provide Peoples with some rate recovery for the  
48 cost of accelerating the replacement of CI/DI main between rate cases. While Peoples  
49 Gas was amenable to revising its Rider ICR to comport with Ms. Hathhorn's Rider ICR  
50 approach, Peoples Gas does not believe that every single element of Ms. Hathhorn's  
51 proposal should be applied to its program.

52 Q. Why do you believe a rate of return credit is inappropriate for Rider ICR?

53 A. As I stated above, People Gas' proposal was intended to be an uncomplicated recovery  
54 mechanism which only sought to provide the Company with an opportunity to recover  
55 two specific elements of its costs of the Accelerated Program, *i.e.*, return and  
56 depreciation. The Company did not propose an evaluation of other values in the  
57 Company's rates which could be affected by the installation of new plant, such as tax  
58 effects, earnings impacts and operations impacts. Such a broad evaluation of impacts and  
59 the creation of a methodology which would measure those impacts on the rates in the  
60 Rider would be overly complicated and defeat the purpose of the Rider.

61 Q. How would the inclusion of additional calculations and evaluations complicate the Rider?

62 A. Several parties in this proceeding, particularly GCI witness Mr. Brosch and Staff witness  
63 Mr. Lazare, have criticized the Companies' Rider proposals as overly complex and  
64 administratively burdensome. While I do not agree that the proposals, as filed, are

65 complex or burdensome, I believe that the introduction of requirements to give rate effect  
66 to values, such as tax effects, rate of return impacts and other such measures, would most  
67 certainly add a level of complexity to the Accelerated Program recovery that is  
68 unwarranted. Consideration of all of the variables that might be impacted by the  
69 installation of CI/DI replacement facilities is a task which can only be accomplished  
70 realistically in a general rate case proceeding. The purpose of Rider ICR is to give the  
71 Company a means of recovering its costs between rate cases. In addition, the Accelerated  
72 Program and Rider ICR are intended to operate as a distinct and defined recovery  
73 mechanism. As such, other aspects of the utility's business, such as, its overall earnings  
74 or its earnings in relation to its authorized return, are entirely separate matters.

75 Q. How would a return credit or tax adjustment defeat the purpose of a rider?

76 A. I believe an appropriately crafted rider should be narrowly crafted to recover a distinct  
77 and particular cost of a utility's operations. The purpose of a rider is not to undertake  
78 considerable effort and calculations associated with a rate case. Indeed, the total impact  
79 of the many values and variables that might be affected by a rider rate adjustment will  
80 always be eventually evaluated in the next succeeding rate case. In the case of  
81 Rider ICR, all impacts will be accounted for when the new plant is included in rate base  
82 in a new general rate proceeding.

83 Q. In her Rebuttal Testimony at lines 410-414, Ms. Hatthorn states that "there is no reason  
84 not to implement this credit provision to prevent the Company from excess earnings  
85 under this rider." Do you agree with her opinion?

86 A. No, I do not. There are several reasons why this credit mechanism should not be  
87 included in Rider ICR. First, this is yet another instance of a party proposing to introduce

88 more administrative complexity while arguing that the rider should be rejected because of  
89 the administrative complexity. The effort required to determine this credit and then to  
90 audit this credit will approach the amount of effort required for a full blown rate case.

91 Q. For what other reason is the credit mechanism inappropriate?

92 A. The credit mechanism is inappropriate for Rider ICR because it could have the perverse  
93 effect of eliminating recovery of the very costs Rider ICR is designed to recover.  
94 Rider ICR is designed to recover costs the Company actually expends for infrastructure  
95 replacement. If the Company does not incur costs, there is no ICR revenue. The ICR  
96 revenue only recovers costs that are incurred. If the credit operates to limit or reduce the  
97 ICR revenue, the Company will be precluded from recovering the costs it would have  
98 actually expended for infrastructure replacement. Thus, even after the Company will  
99 have paid for infrastructure replacement and collected the allowed recovery from  
100 customers, the credit would, in effect, cause the Company to disgorge those collections  
101 and eliminate the very recovery of costs intended by the operation of Rider ICR .

102 Q. If the credit were a component of Rider ICR, what impact would it have on the  
103 Accelerated Program?

104 A. A credit would act as a disincentive to conduct infrastructure replacement, except when  
105 the Company was not earning its full authorized rate of return (ROR).

106 Q. Please provide an example of how the credit could be a disincentive to the Company  
107 implementing the Accelerated Program.

108 A. Let us assume the Company were authorized an ROR at the Company's original  
109 requested level of 8.25% and due to other factors, such as weather, the Company was

110 able to earn 8.75% before any infrastructure costs were incurred. Assume further that the  
111 Company was to incur infrastructure replacement costs such that the ROR was only  
112 8.3%, the Rider ICR would allow recovery of those costs such that the Company earned  
113 ROR would return to approximately 8.75%.<sup>1</sup> If the credit were in place, however, the  
114 Company would have to refund the Rider ICR recovery, bringing the earned ROR back  
115 down to 8.3%, and leaving the Company worse off than if it had never made the  
116 infrastructure investment.

117 Q. Aside from demonstrating how the credit proposal would be a disincentive, what else  
118 does the above example demonstrate?

119 A. The example is a vivid illustration of the added complexity a return credit would inject  
120 into the Rider ICR calculation and administration. Moreover, the example illustrates how  
121 the credit would have the anomalous effect of reducing the Company's earnings when the  
122 Rider itself can never result in the Company over-earning. By definition, the Rider is  
123 only intended to allow recovery of the Company's cost of capital. It is wholly  
124 inappropriate to bring other factors, such as the Company's earning in other business  
125 segments, into the calculation or to otherwise diminish the Company's recovery of the  
126 infrastructure replacement cost of capital.

127 Q. Are any of the Company's other effective Riders subject to a return adjustment?

128 A. No.

---

<sup>1</sup> It would actually be slightly less than the ROR without the replacement program since the additional investment only earns at the authorized rate of return and would, in effect, dilute the earned rate of return from what it would have been without the infrastructure replacement program.

129 Q. Do you wish to address any other matters raised in the Rebuttal Testimony of others?

130 A. Yes. Staff witness Mr. Lazare asserts in his Rebuttal Testimony at lines 533 through 542  
131 that Rider ICR should not be approved because it would increase customer bills between  
132 rate cases. Such an approval, according to Staff Witness Lazare, “would amount to an  
133 extraordinary cost for ordinary service.” By its very nature, however, a Rider adjusts a  
134 utility’s rates periodically between rate cases. These characteristics are inherent in any  
135 rider or tracking mechanism. Thus, Mr. Lazare’s criticism seems to be borne of his  
136 disapproval of rider or tracker mechanisms in general. Since the Commission has  
137 employed these types of rate mechanisms in the past, Mr. Lazare’s discontentment with  
138 the characteristics of rate riders is misplaced. Mr. Lazare’s disquiet with riders and their  
139 inherent characteristics should not obscure the importance of the Accelerated Program  
140 and proposed Rider ICR. As I indicated in my Direct Testimony, an important benefit of  
141 the Accelerated Program is modernization of the Peoples distribution system. I have  
142 attached, as North Shore/Peoples Gas Ex. JFS-3.1, two maps of the Peoples Gas system  
143 which show the extent to which old CI/DI main still represents a considerable portion of  
144 the Peoples Gas facilities. One of the maps reflects CI/DI main on the high pressure  
145 portion of the system and the other reflects low pressure system CI/DI mains. Bringing  
146 the Peoples system up to date with the most modern and reliable facilities is an important  
147 contribution to the improvement and modernization of the overall Chicago infrastructure.  
148 The need to upgrade and modernize the Chicago utility infrastructure is simply one  
149 element in the more considerable infrastructure challenges faced throughout the country  
150 and in Illinois.

151 Q. Please discuss Mr. Brosch’s dissatisfaction with proposed Rider ICR.

152 A. In his Rebuttal Testimony on pages 34-35, Mr. Brosch reiterated his criticism of  
153 Rider ICR in light of the revisions proposed by Ms. Hathhorn and accepted by the  
154 Company. Mr. Brosch specifically asserts that the new language to which the Company  
155 has agreed in the Rider ICR injects additional complexity in the administration of  
156 Rider ICR.

157 Q. How would the Company address Mr. Brosch's criticism?

158 A. As I indicated earlier in my Surrebuttal Testimony, to address two of the "mechanical  
159 problems" asserted by Mr. Brosch, the absence of a means to account for deferred taxes  
160 and depreciation reserves effects, would actually have the effect he criticizes, *i.e.*, adding  
161 unreasonable complexity to the proposal. I have earlier testified that consideration of all  
162 the factors that impact operations would require an extensive analysis akin to a rate case.  
163 I discussed above the complexity associated with an adjustment for return and the same  
164 complexity attends accounting for productivity gains, replacement facilities cost savings  
165 and numerous other factors.

166 Q. Are there any cost reductions that could be reasonably quantified?

167 A. Perhaps, there are two. The Company has recently performed an analysis which offers an  
168 indication of leak savings that might ensue from the Accelerated Program. The analysis  
169 is attached to my testimony as North Shore/Peoples Gas Ex. 3.2 which is a supplemental  
170 response to Data Request No. AG-8.02. The Exhibit reflects a potential \$3,000 per mile  
171 in annual leak repair savings that might be achieved if the Accelerated Program were  
172 implemented.

173 Q. What other factor could be reasonably quantified?

174 A. The effect of Rider ICR costs on deferred taxes could be a straightforward, though very  
175 complicated calculation.

176 Q. Do you have any comment on Mr. Brosch's criticism of the Company's revisions to  
177 Ms. Hathhorn's proposal?

178 A. Yes. The Company is agreeable to removing the language of which Mr. Brosch is  
179 critical. Ms. Grace has included in her Surrebuttal Testimony new proposed Rider ICR  
180 tariff sheets which reflect deletion of Peoples Gas' revisions to Ms. Hathhorn's criteria  
181 addressing such matters as facilities which are worn out, deteriorated, obsolete, dead ends  
182 and relocations as discussed by Mr. Brosch on pages 34-35 of his Rebuttal Testimony.

183 Q. Is there any other matter you would like to address?

184 A. Yes, there is. Mr. Brosch indicated in his Direct Testimony that he was testifying on  
185 behalf of the People of the State of Illinois, the City of Chicago (City) and the Citizens  
186 Utility Board. In his Rebuttal Testimony, however, he indicated that the City is not a  
187 sponsor of his testimony in respect of Rider ICR.

188 Q. What do you believe is the significance of Mr. Brosch's statement?

189 A. It appears that the City is no longer in support of Mr. Brosch's opposition to Rider ICR.

190 Q. Does this mean that the City supports Rider ICR?

191 A. I would hope that the City's withdrawal from sponsorship of Mr. Brosch's testimony in  
192 opposition to Rider ICR is an indication of the City's recognition of the benefits that will  
193 result from the Accelerated Program and that such recognition will eventuate in the City  
194 offering its affirmative support for Rider ICR.

195 Q. Does this conclude your Surrebuttal Testimony?

196 A. Yes it does.