

**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.	:	

Revised 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

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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”) and North Shore  
7 Gas Company (“North Shore”) (together, “the Utilities”) in this consolidated Docket?

8 A. Yes.

9 **B. Purposes of Testimony**

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

11 A. The purpose of my Surrebuttal Testimony is to address certain alleged deficiencies of  
12 Peoples’ revised Rider ICR proposal as modified by the concession to accept Staff  
13 Witness Hathhorn’s Rider QIP framework.

14 **C. Summary of Conclusions**

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

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

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

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

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

27 **II. PROPOSED RIDER ICR**

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

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

31 Q. What are those modifications?

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

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

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

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

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

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

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

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

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

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

61 A. Several parties in this proceeding, particularly Mr. Bosch and Mr. Lazare, have criticized  
62 the Companies' Rider proposals as overly complex and administratively burdensome.  
63 While I do not agree that the proposals, as filed, are complex or burdensome, I believe  
64 that the introduction of requirements to give rate effect to values, such as tax effects, rate  
65 of return impacts and other such measures, would most certainly add a level of  
66 complexity to the Accelerated Program recovery that is unwarranted. Consideration of

67 all of the variables that might be impacted by the installation of CI/DI replacement  
68 facilities is a task which can only be accomplished realistically in a general rate case  
69 proceeding. The purpose of Rider ICR is to give the Company a means of recovering its  
70 costs between rate cases. In addition, the Accelerated Program and Rider ICR are  
71 intended to operate as a distinct and defined recovery mechanism. As such, other aspects  
72 of the utility's business, such as, its overall earnings or its earnings in relation to its  
73 authorized return, are entirely separate matters.

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

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

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

85 A. No I do not. There are several reasons why this credit mechanism should not be included  
86 in Rider ICR. First, this is yet another instance of a party proposing to introduce more  
87 administrative complexity while arguing that the rider should be rejected because of the  
88 administrative complexity. The effort required to determine this credit and then to audit  
89 this credit will approach the amount of effort required for a full blown rate case.

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

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

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

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

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

107 A. Let us assume the Company were authorized an ROR at the Company requested level of  
108 8.25% and due to other factors, such as weather, the Company was able to earn 8.75%  
109 before any infrastructure costs were incurred. Assume further that the Company was to  
110 incur infrastructure replacement costs such that the ROR was only 8.3%, the Rider ICR  
111 would allow recovery of those costs such that the Company earned ROR would return to

112 approximately 8.75%.<sup>1</sup> If the credit were in place, however, the Company would have to  
113 refund the Rider ICR recovery, bringing the earned ROR back down to 8.3%, and leaving  
114 the Company worse off than if it had never made the infrastructure investment.

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

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

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

126 A. No.

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

128 A. Yes. Staff witness Lazare asserts in his Rebuttal Testimony at lines 533 through 542 that  
129 Rider ICR should not be approved because it would increase customer bills between rate  
130 cases. Such an approval, according to Staff Witness Lazare, "would amount to an  
131 extraordinary cost for ordinary service." By its very nature, however, a Rider adjusts a

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<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.

132 utility's rates periodically between rate cases. These characteristics are inherent in any  
133 rider or tracking mechanism. Thus, Mr. Lazare's criticism seems to be borne of his  
134 disapproval of rider or tracker mechanisms in general. Since the Commission has  
135 employed these types of rate mechanisms in the past, Mr. Lazare's discontentment with  
136 the characteristics of rate riders is misplaced. Mr. Lazare's disquiet with riders and their  
137 inherent characteristics should not obscure the importance of the Accelerated Program  
138 and proposed Rider ICR. As I indicated in my Direct Testimony, an important benefit of  
139 the Accelerated Program is modernization of the Peoples distribution system. I have  
140 attached, as North Shore/Peoples Gas Ex. JFS-3.1, two maps of the Peoples Gas system  
141 which show the extent to which old CI/DI main still represents a considerable portion of  
142 the Peoples Gas facilities. One of the maps reflects CI/DI main on the high pressure  
143 portion of the system and the other reflects low pressure system CI/DI mains. Bringing  
144 the Peoples system up to date with the most modern and reliable facilities is an important  
145 contribution to the improvement and modernization of the overall Chicago infrastructure.  
146 The need to upgrade and modernize the Chicago utility infrastructure is simply one  
147 element in the more considerable infrastructure challenges faced throughout the country  
148 and in Illinois.

149 Q. Please discuss Mr. Brosch's dissatisfaction with proposed Rider ICR.

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

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

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

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

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

170 Q. What other factor could be reasonably quantified?

171 A. The effect of Rider ICR costs on deferral taxes could be a straightforward, though very  
172 complicated calculation.

173 Q. Do you have any comment on Mr. Brosch’s criticism of the Company’s revisions to Ms.  
174 Hathorn’s proposal?

175 A. Yes. The Company is agreeable to removing the language of which Mr. Brosch is  
176 critical, as discussed by Mr. Brosch on pages 34-35 of his Rebuttal Testimony.

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

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

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

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

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

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

189 Q. Does this conclude your Surrebuttal Testimony?

190 A. Yes it does.