STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

POST-HEARING REPLY BRIEF OF NORTH SHORE GAS COMPANY AND THE PEOPLES GAS LIGHT AND COKE COMPANY

John P. Ratnaswamy
Christopher P. Zibart
Bradley D. Jackson
FOLEY & LARDNER LLP
321 N. Clark Street, Suite 2800
Chicago, Illinois 60610
(312) 832-4500
jratnaswamy@foley.com
czibart@foley.com
bjackson@foley.com

Emmitt C. House
Timothy W. Wright
Jerome Mrowca
GONZALEZ, SAGGIO & HARLAN, L.L.C.
35 E. Wacker Drive, Suite 500
Chicago, Illinois 60601
(312) 638-0012
emmitt_house@gshllp.com

Gerard T. Fox
Mary P. Klyasheff
INTEGRYS ENERGY GROUP, INC.
130 East Randolph Street
Chicago, Illinois 60601
(312) 240-4341
gtfox@integrysgroup.com
mpklyasheff@integrysgroup.com

Dated: October 23, 2007

TABLE OF CONTENTS

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

TABLE OF CONTENTS (*cont'd*)

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

POST-HEARING REPLY BRIEF OF NORTH SHORE GAS COMPANY AND THE PEOPLES GAS LIGHT AND COKE COMPANY

North Shore Gas Company ("North Shore") and The Peoples Gas Light and Coke Company ("Peoples Gas") (together the "Utilities" or the "Companies"), by their counsel, submit this Post-Hearing Reply Brief.

I. INTRODUCTION

A. Summary

1. Overview

The Utilities' final revised proposals should be approved. They are consistent, supported by compelling evidence, and will result in rates that are just and reasonable for customers as well as the Companies. The Utilities filed fair and sensible revised tariffs and new Riders that reflect the changes in their business and public policy since their base rates last were set, in 1995, and they have listened to other parties' proposals in these proceedings. For example, they have accepted 20 rate base and operating expenses adjustments proposed by "GCI"[1] and Staff.

In contrast, GCI's and Staff's positions on many key contested issues not only lack merit, but they also suffer from two serious overall problems: inconsistency and inflexibility. First,

[1] The Illinois Attorney General's Office (the "AG"), the Citizens Utility Board ("CUB"), and the City of Chicago (the "City") (collectively "GCI").

GCI's and Staff's positions are shot through with contradictions, as to which they try to "have it both ways". Examples of this problem are discussed in the next subsection of this Reply Brief.

Second, GCI's and Staff's positions suffer from rigidity. GCI and Staff largely fail to recognize, or they disregard, the changes in the business environment and in the public policy framework within which the Utilities serve their customers. Except for the City's support of Peoples Gas' new infrastructure rider, "Rider ICR", GCI and Staff ignore, or they brush aside, how the Utilities' proposed new Riders greatly would benefit customers.

In addition, Staff largely ignores the reorganization of the Utilities and focuses on past disputes when addressing the subjects of Peoples Gas' Hub services and the new Riders. The Illinois Commerce Commission (the "Commission" or "ICC") approved the reorganization in *In re WPS Resources Corp.*, *et al.*, ICC Docket No. 06-0540 (Order Feb. 7, 2007). Integrys Energy Group, Inc. ("Integrys"), now is the parent of Peoples Energy Corporation, which in turn is the parent of the Utilities. *E.g.*, Borgard Dir., Peoples Gas ("PGL") Exhibit ("Ex.") LTB-1.0, 4:82-84. Lawrence Borgard is now the President and Chief Operating Officer of Integrys Gas Group and Vice Chairman of the Board and Chief Executive Officer of North Shore and Peoples Gas. *Id.*, 1:6-8. The Companies are fully carrying out the Commission's Conditions for approving the reorganization. *E.g.*, *id.*, 3:55-57, 22:482-492, 30:667-695; PGL Ex. LTB-1.6. Yet, many of Staff's arguments relating to the Hub services and new Riders read as if the instant cases were about the issues that arose out of events in years before the reorganization and before the test year and were resolved by the Gas Charge settlement approved by the Commission in March 2006 in ICC Docket Nos. 02-0726, 02-0727, 03-0704, 03-0705, 04-0682, and 04-0683. The instant proceedings are not those Dockets. The Commission's final Order in these rate cases must be within its jurisdiction and authority, must be lawful, and must be based exclusively on the evidence in the record of these proceedings, not on the evidence of other Dockets. *E.g.*, 220 ILCS 5/10-103, 10-201(e)(iv); *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 136 Ill. 2d 192, 201, 227 (1989).

Other intervenors besides GCI pursue various contested proposals. Most of those intervenors are alternate gas suppliers and transportation customers. With regard to the contested issues, they generally seek costs of service, rate design, and terms and conditions changes that would serve their particular economic interests. Their proposals, in many instances, do not accord with sound cost of service and ratemaking principles, are not consistent with the operation of the Utilities' systems and business processes, or would inappropriately shift costs and burdens to other customers or the Utilities.

The two remaining parties are the Environmental Law and Policy Center ("ELPC") and Local Union No. 18007, Utility Workers Union of America, AFL-CIO ("Local 18007"). ELPC supports the Utilities' proposed energy efficiency program, although ELPC believes that its costs should be recovered through base rates rather than the applicable new rider, "Rider EEP". Local 18007 proposes that the Commission impose strictures on the Companies' management that would require the filling of many employee positions (i.e., the Union positions) when they become vacant regardless of whether management believes the positions should be filled. Local 18007's proposal is not consistent with the respective roles of management and the Commission.

The Commission should approve the Utilities' revised tariffs and new Riders. The evidence shows that, in so doing, the Commission will meet the fundamental requirement of establishing rates that are just and reasonable for customers as well as the Utilities and their shareholders. 220 ILCS 5/9-201(c); *Business and Professional People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 208 (1991).

2. <u>GCI's and Staff's Inconsistent Positions</u>

In the Overview above, the Utilities observed that GCI's and Staff's respective positions as to many key contested issues are replete with contradictions as to which they try to "have it both ways". This subsection of this Reply Brief provides illustrations of that serious problem.

<u>GCI's Inconsistent Positions on the Weather Normalization Period and Riders VBA and WNA</u>. Once a gas utility's revenue requirement is determined and allocated, its charges are calculated based on its billing determinants, including, as to volumetric charges, its normal level of heating degree days ("HDDs"). GCI strenuously argues for use of a 30-year period for weather normalization, claiming, among other things, that using the 10-year period will under-estimate HDDs. *E.g.*, AG Initial Brief ("Init. Br.") at 21-23; *see also* City-CUB Init. Br. at 58-63. Yet, when it comes to the Utilities' proposed decoupling Rider, "Rider VBA", and their alternative weather normalization adjustment Rider, "Rider WNA" -- both of which, all else being equal, will give residential and general service customers billing **credits** if weather turns out to be colder than the normal weather level set in these proceedings (*see, e.g.*, North Shore – Peoples Gas ("NS-PGL") Init. Br. at 115-116, 119) -- GCI strenuously opposes these Riders, claiming that they benefit the Utilities, not customers. AG Init. Br. at 29-82; City-CUB Init. Br. at 70-83. GCI cannot have it both ways. If the HDDs resulting from use of the 10-year period are too low, then, all else being equal, customers would benefit from Riders VBA and WNA, not the Utilities. The effects of GCI's inconsistent positions are obvious. Using the 30-year period will yield over-estimated HDDs that will incorrectly reduce the volumetric charges, while opposing Riders VBA and WNA will prevent the Utilities from recovering the revenues lost due to those incorrect low charges, as discussed in Sections VI and VII(B) of this Reply Brief, below.

GCI's Inconsistent Positions on the Significance of Climate Change. Independent climate scientist Dr. Eugene Takle, a contributor to the Intergovernmental Panel on Climate Change, testified that using data from O'Hare for the most recent 10-year period to predict HDDs is more accurate than using data for a 30-year period, based on data regarding global warming, the relationship between U.S. and global temperatures, the relationship between O'Hare HDDs and U.S. temperatures, and other data. *E.g.*, Takle Dir., PGL Ex. EST-1.0, 8:164-171, 32:696-711. The AG, arguing for use of a 30-year period, brushes aside Dr. Takle's testimony, ignores his conclusion on the most accurate period, and implies (incorrectly) that he relied only on a single 1990 study. *See* AG Init. Br. at 25-27. [2] Yet, six months ago, the AG, having filed a joint petition with other states and organizations (not parties here) that called global warming "the most pressing environmental challenge of our times", prevailed in *Massachusetts, et al., v. Env'tal Protection Agency, et al.*, No. 05-1120, slip. op. at 1 (U.S. S. Ct. April 2, 2007) (EPA has statutory authority to regulate emission of greenhouse gases from new motor vehicles; EPA's grounds for inaction were based on impermissible considerations).

GCI's and Staff's Inconsistent Positions Relating to the Merits of "Traditional Ratemaking". GCI and Staff both strongly espouse "traditional ratemaking" in the face of the Utilities' advocacy of Riders VBA and WNA. *E.g.*, AG Init. Br. at 29-31; City-CUB Init. Br. at 70-75; Staff Init. Br. at 123-127. Yet, GCI and Staff emphasize that the Utilities experienced significant continuing declines in natural gas usage per customer since the early 1990's, and significant declines in base rate revenues (the revenues that cover the costs and expenses included in their revenue requirements, *i.e.*, margin revenues) since 2003, arguing that, in the face of those problems, the Utilities' not filing rate cases until 2007 must mean that "traditional

[2] Staff accepts the Utilities' use of the 10-year period. Staff Init. Br. at 171.

ratemaking" remains preferable. *E.g.*, AG Init. Br. at 2, 46; City-CUB Init. Br. at 75,80; Staff Init. Br. at 155-156. That is illogical. The Utilities' forbearing, in the face of these developments, from filing rate cases is not evidence that "traditional ratemaking" is working well, much less that it is preferable to the decoupling or weather normalization adjustment riders adopted in other states and embodied in Riders VBA and WNA. Also, GCI and Staff conveniently ignore, as reasons for the Utilities' not filing rate causes sooner, that the Utilities were litigating and negotiating the Gas Charge issues and their settlement (approved in March 2006) and the proposed reorganization (approved in February 2007).

Staff's Inconsistent Positions on Hub Services Costs and Revenues. Staff proposes to disallow nearly $40 million of gross plant and over $2 million of gross operating expenses of Peoples Gas, based primarily on the theory that Peoples Gas' Hub services are imprudent because the costs outweigh the revenues. Staff Init. Br. at 111. Yet, it is uncontested that, under the Gas Charge settlement, all revenues of the Hub services are credited to Peoples Gas' customers through reductions its "Rider 2" Gas Charges, including a gross $20 million in 2005 and 2006 and a forecasted gross $13 million in 2007. NS-PGL Init. Br. at 99. Staff's position of disallowing all of the costs (which they have miscalculated) without making any offset for the revenues is unreasonable and unfair and, not surprisingly, it is inconsistent with the Commission's approach to calculating disallowances where imprudence is found. When imprudence is found, only its incremental impact, if any, is disallowed. *E.g.*, *In re Central Ill. Light Co.*, ICC Docket No. 94-0040, 1994 Ill. PUC Lexis 577, **38-42 (Order Dec. 12, 1994).

GCI's and Staff's Inconsistent Positions on OPEB Liabilities and Pension Asset/Contributions. GCI proposes, and Staff concurs, to subtract nearly $56 million from Peoples Gas' rate base, and over $7 million from North Shore's rate base, based on the

Companies' respective "OPEB" (Post-Retirement Benefits Other Than Pensions) liabilities. AG Init. Br. at 11-13; City-CUB Init. Br. at 16-18; Staff Init. Br. at 16-18. Yet, GCI and Staff simultaneously refuse to take into account Peoples Gas' net pension asset of $110 million, based on the theory that these are customer-supplied funds, despite the uncontested fact that Peoples Gas contributed over $15 million to the plan in the test year. NS-PGL Init. Br. at 31-33. GCI's and Staff's positions not only are contradictory as to treatment of the OPEB and pension balance sheet items, but they are inconsistent with the Commission's recently having approved recovery, at a debt rate of return, of a utility's contribution to a net pension asset. *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, pp. 28-29 (Order on Rehearing Dec. 20, 2006).

GCI's Inconsistent Positions on the Test Year, Depreciation Reserves, and *Pro Forma* Adjustments Based on Inflation and Attrition. GCI opposed, as inconsistent with test year principles and the "[a]ttrition or inflation" clause of the Commission's *pro forma* adjustments rule, 83 Ill. Adm. Code Part 287, the Utilities' proposed *pro forma* adjustments for non-payroll expenses inflation. Effron Dir., GCI Ex. 2.0, 26:571 – 28:640. The Utilities withdrew those adjustments. Yet, GCI proposes to add a full year of depreciation expense to each utility's Accumulated Reserve for Depreciation and Amortization (the "Depreciation Reserve"), over $43 million as to Peoples Gas and nearly $6 million as to North Shore, thereby reducing their rate bases by the same amounts. AG Init. Br. at 6-11; City-CUB Init. Br. at 9-16. GCI's proposed adjustments are inconsistent with test year principles and the *pro forma* adjustments rule (NS-PGL Init. Br. at 18-21; Kahle Corr. Reb., Staff Ex. 15.0, 17:346-359), as is illustrated by comparing them with GCI's position on the Utilities' withdrawn proposed *pro forma* adjustments for non-payroll expenses inflation.

<u>Staff's Inconsistent Positions on Determining the Rate of Return on Common Equity ("ROE")</u>. Staff's arguments on the Utilities' authorized ROEs are fraught with contradictions. (1) Staff argues that the Utilities' "financial leverage" adjustment to the ROE models lacks any basis in financial theory, when Staff's own "financial risk" adjustment to the ROE models relies on the very same financial theory. NS-PGL Init. Br. at 71, 85-86. (2) Challenging the Utilities' financial leverage adjustment, Staff argues that if a utility has a market-to-book ratio over 1.0, it can be due to only one of two reasons: (a) the investor-required rate of return has fallen or (b) expectations of future earnings have risen. Staff Init. Br. at 62. At the same time, Staff challenges CUB-City's position that a utility's market value should never exceed book value as "oversimplified," pointing out that there are many utility ratemaking practices that can result in a utility's market value exceeding its book value. *Id.* at 73. (3) Staff argues that historical data has no place in the application of the financial models. Staff Init. Br. at 68-70. But Staff's cost of equity witness uses historical data in her application of the "CAPM" model, and her claim that it is unavoidable is incorrect. NS-PGL Init. Br. at 77-78. (4) Staff claims that single-day spot market data is the only valid data for the financial models, yet Staff's criticisms of the use of historical data apply equally if not more so to the use of spot data. *Id*. at 78-79. (5) Staff says that ROEs should be based on what investors <u>do</u> expect, not what they <u>should</u> expect. Staff Init. Br. at 67. But Staff calculates its own CAPM betas instead of relying on the *Value Line* betas that investors actually rely on. NS-PGL Init. Br. at 80. (6) Staff accepts the Utilities' proxy group of gas utilities as having a balance of risk comparable to the Utilities, but then applies a formula to calculate an ROE adjustment based on an asserted difference in financial risk based on assumed stand-alone credit rating. Either the proxy group is comparable on a "balance of risk" basis or not. Staff cannot have it both ways. *Id*. at 83-85.

The foregoing examples of GCI's and Staff's inconsistencies within and between positions, and their attempts to "have it both ways", are not exhaustive. Those and other instances are discussed further in the body of the Utilities' Initial Brief and below.

B. <u>Nature of Operations</u>

1. <u>Peoples Gas</u> and 2. <u>North Shore</u> (Combined Discussion)

No other party addressed these subjects as such in its Initial Brief. The Utilities note that some parties have made proposals that are inconsistent with the design and/or operation of the Utilities' systems, as is discussed in the applicable Sections of this Reply Brief, *infra*.

C. <u>Test Year (Uncontested)</u>

The Utilities' proposed test year, fiscal year 2006, should be approved. NS-PGL Init. Br. at 13 No other party addressed this subject as such in its Initial Brief. The Utilities note that GCI has proposed adjustments to the Utilities' Depreciation Reserves that are inconsistent with test year principles, as is discussed in Section II(D)(1) of this Reply Brief, *infra*.

II. <u>RATE BASE</u>

A. <u>Overview</u>

Peoples Gas' final proposed rate base of $1,289,531,000 and North Shore's final proposed rate base of $193,577,000 should be approved. The Utilities' rate base figures appropriately and correctly reflect the prudent, reasonable cost, and used and useful investments that they have made in their systems in order to serve their customers. The Initial Briefs submitted by Staff and GCI[3] do not alter that their respective contested proposed rate base adjustments are not supported by the evidence or the law.

Staff's and GCI's respective proposed rate base figures, as aggregate amounts, are questionable on their faces. Peoples Gas' unadjusted actual rate base at the end of the test year, fiscal year 2006, was $1,210,229,000. PGL Ex. SF-1.1, Sched. B-1, line 15, column [D]. That figure does not include Peoples Gas' uncontested *pro forma* adjustment for post-test year capital additions of a net $87,403,000.[4] Yet, Staff's final proposed rate base for Peoples Gas is $1,168,331,000 (Staff Init. Br., App. A, p. 4, line 23, column (d)), and GCI's final proposed rate base for Peoples Gas is $1,215,362,000 (AG Init. Br. at 13 (citing GCI Ex. 5.1, Sched. B Rev.)). Their proposed total figures beg explanation in these circumstances.[5] The explanation, however, is that Staff's and GCI's underlying proposed adjustments lack merit, as is discussed below.

The Utilities note that the AG has not correctly stated the applicable law, in certain respects. The AG is correct that the Commission must establish rates that are just and reasonable to ratepayers and to the utility and its stockholders. AG Init. Br. at 3-4; NS-PGL Init. Br. at 5. The AG's discussion of the burden of proof (AG Init. Br. at 3), however, does not fully set forth the applicable law. A utility bears the burden of proof that its proposed rates are just and

[3] The Utilities generally refer herein to "GCI's" positions on rate base and operating issues. The AG and City-CUB as "GCI" jointly submitted the testimony of David Effron as their sole witness on these issues, and, while they have filed separate Initial Briefs, they do not appear to have changed any of their proposals on these issues.

[4] The $87,403,000 figure = the original net amount of $95,464,000 (PGL Ex. SF-1.1, Sched. B-2, column [B]) minus an agreed net amount of $8,061,000 (NS-PGL Ex. SF-4.2P, column [D]; NS-PGL Init. Br. at 16-17).

[5] The situation is similar as to North Shore. North Shore's unadjusted actual rate base as of the end of the test year was $187,208,000 (NS Ex. SF-1.1, Sched. B-1, line 13, column [D]), and its uncontested *pro forma* adjustment for post-test year capital additions is a net $9,899,000 (NS Ex. SF-1.1, Sched. B-2., column [B]; NS-PGL Init. Br. at 16-17). Yet, Staff and GCI propose rate bases for North Shore of only $181,332,000 and $184,880,000, respectively. Staff Init. Br., App. B, p. 4, line 23, column (d); AG Init. Br.at 13 (citing GCI Ex. 5.1, Sched. B Rev.).

reasonable, 220 ILCS 5/9-201(c), but once it makes out a *prima facie* case, the burden of going forward with the evidence shifts to the other parties that challenge its costs.

> In proceedings before the Commission, once a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a *prima facie* case. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).* The burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).*

Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 327 Ill. App. 3d 768, 776 (3d Dist. 2002).[6] Also, the AG has not accurately identified the applicable law on inclusion of plant in rate base. A utility is legally entitled to include in rate base plant that is prudently acquired, reasonable in cost, and used and useful. 220 ILCS 5/9-211; *In re Commonwealth Edison Co.*, ICC Docket No. 94-0065, 1995 Ill. PUC Lexis 25, *5 (Order Jan. 9, 1995), *aff'd in part and remanded in part on other grounds*, 291 Ill. App. 3d 300 (1st Dist. 1997). The AG cites not Section 9-211 but rather Sections 9-212 and 9-213 of the Public Utilities Act, 220 ILCS 5/9-212, 9-213, and decisions thereunder, but those Sections expressly apply only to new electric utility generating plant, new gas production facilities, and significant additions (as defined) thereto. In any event, the evidence supports Peoples Gas' and North Shore's final proposed rate bases.

B. Uncontested Issues

1. Original Cost Determination as to Plant Balances as of 9/30/06

Staff's proposed findings on original cost determinations should be adopted. NS-PGL Init. Br. at 16; Staff Init. Br. at 3-4. No other party addressed this subject in its Initial Brief.

[6] The law also is clear that the utility does not bear the burden of proof on all the issues that conceivably are relevant to the reasonableness of its rates, nor is it required in its direct case to anticipate and disprove the objections that opposing parties might make. *City of Chicago*, 133 Ill. App. 3d at 442.

2. ***Pro Forma* Capital Additions**[7]

Staff's final revised figures as presented in its rebuttal testimony for the Utilities' *pro forma* adjustments for post-test year capital additions, modified by addition of $10,405,000 of Peoples Gas' cushion gas additions, should be used as the final figures for these adjustments. NS-PGL Init. Br. at 16-17; Staff Init. Br. at 4-5. No party besides the Utilities and Staff addressed this subject as such in its Initial Brief. The Utilities note that GCI seeks to use these adjustments as a pretext for GCI's improper and incorrect proposed adjustments to the Utilities' Depreciation Reserves, as is addressed in Section II(D)(1) of this Reply Brief, *infra*.

3. **Capitalized Lobbying Expenses**

Please see Section III(B)(5)(d) of this Reply Brief, *infra*.

4. **Capitalized City of Chicago Resurfacing Costs (PGL)**

No other party addressed this subject in its Initial Brief.

5. **ADIT - Gas Cost Reconciliation**

No other party addressed this subject in its Initial Brief.

6. **[ADIT -] AMT - Gas Charge Settlement**

No other party addressed this subject in its Initial Brief.

C. **Plant**

1. **Capitalized Incentive Compensation**

Please see Section III(C)(3)(b) of this Reply Brief, *infra*.

---

[7] As indicated in their Initial Brief (at 14 and 16 n. 4), the Utilities agreed with or, in order to narrow the issues, accepted the Staff and GCI proposed adjustments discussed in Section II(B)(2) through II(B)(5) of the Utilities' Initial Brief. Thus, the Utilities do not agree with all of the rationales given by Staff and GCI for their positions on these subjects in their respective Initial Briefs. The Utilities have not waived their right to pursue these issues in future rate proceedings.

2. **<u>Hub Services (PGL)</u> (To be addressed in Section V, below)**

D. <u>Reserve for Accumulated Depreciation and Amortization</u>

1. <u>GCI's Proposed Adjustments</u>

The Initial Brief of the Utilities (at 3, 18-21) showed that GCI witness Mr. Effron's proposed adjustments to their Depreciation Reserves are unjustified and improper. The Initial Briefs of the AG and City-CUB each advocate and contain similar arguments with respect to GCI witness Mr. Effron's proposed adjustments to the Companies' Depreciation Reserves, but their arguments are meritless. The AG and City-CUB briefs rely upon and refer to cases which are not on point. They neglect any reference to the two cases that are on point -- the Commission's orders in two Commonwealth Edison Company ("ComEd") rate cases, ICC Docket No. 05-0597 and ICC Docket No. 01-0423 -- cases with virtually the same relevant facts as these proceedings, and cases in which the Commission rejected parallel proposals from Mr. Effron. The AG and City-CUB Initial Briefs also neglect any reference to Staff's position. The Utilities and Staff agree that GCI's proposed adjustments should be rejected because they are inconsistent with test year principles and with the Commission's *pro forma* adjustments rule. Each of the foregoing points is discussed below.

The AG acknowledges that the Utilities' surrebuttal testimony distinguished two of the ICC decisions cited by GCI's witness -- the decisions in ICC Docket No. 02-0837 involving Central Illinois Light Co. ("CILCO") and ICC Docket No. 03-0008 involving AmerenCIPS -- as not relevant because they involved utilities that, unlike North Shore and Peoples Gas, had no increase in net plant. *See* AG Init. Br. at 17; Fiorella Sur., NS-PGL Ex. SF-4.0, 868-171.

The AG then states, refering to the Utilities' surrebuttal testimony, that the "Companies conveniently omit any reference to the Illinois Power case (ICC Docket No. 01-0432) and the

AmerenCIPS and AmerenUE case, (ICC Docket No. 02-0798 (cons.))." AG Init. Br. at 9. The AG overlooks that ICC Docket No. 02-0798 involved the consolidation of two rate cases, one of which was ICC Docket No. 03-0008, which was discussed in the Utilities' surrebuttal testimony. In any event, it was not a question of convenience -- there was no need to refer to them because they do not support GCI's proposals.

In ICC Docket No. 01-0432, Illinois Power Company ("IP"), in a rate case with a test year of calendar 2000, proposed *pro forma* plant additions for projects either funded or approved by September 30, 2001, even though those projects would not be in service until at late as June 30, 2002, 18 months after the close of the test year. GCI there argued that the plant additions should be limited to those in service as of June 30, 2001. The Commission rejected GCI's position, and approved IP's proposed adjustment as to actual expenditures as of September 30, 2001. Order in ICC Docket No. 01-0432 at pp. 18-21. With respect to the Depreciation Reserve, IP had decreased rate base by the amount of the Depreciation Reserve accruing from January 1, 2001, through September 30, 2001, on plant that was in service as of December 31, 2000, the last day of the test year. GCI argued that, if its position limiting plant additions to June 30, 2001, were not accepted, then, alternatively, the Depreciation Reserve should be adjusted to recognize growth through the date that the last of the proposed additions beyond that date actually goes into service, i.e., June 30, 2002. Again, the Commission rejected GCI's argument and accepted the position of IP. *Id.* at pp. 20-21.

In ICC Docket No. 02-0798 Cons., AmerenUE and AmerenCIPS proposed *pro forma* adjustments to rate base for major plant additions occurring after the historical test year (the 12 month period ending June 30, 2002), but within twelve months of the filing of the rate case. The AG there argued that, because net plant in service had decreased slightly over the past five years for AmerenUE and had remained almost level for AmerenCIPS, allowing the post-test year additions without also adjusting the Depreciation Reserves for existing plant would distort revenue requirements. The AG argued, therefore, for disallowing the additions or, in the alternative, for reducing them to account for any offsetting post-test year increases in the Depreciation Reserves. The result of the AG's position would be to eliminate the AmerenCIPS additions, but to allow a portion of the AmerenUE additions because they were only partly offset. Staff supported the AG's recommendations based on those facts (in briefing). The Commission, distinguishing ICC Docket Nos. 01-0423 and 01-0432, concluded that while AmerenUE and AmerenCIPS had the right to propose *pro forma* adjustments for post-test year capital additions in an historical test year rate case, the *pro forma* adjustments should not be adopted if they conflict with test year principles, and, accordingly, did not approve AmerenCIPS' proposed additions, and approved in the reduced amount AmerenUE's proposed additions. Order in ICC Docket No. 02-0798 Cons. at pp. 6-11.

Finally, the AG also cites ICC Docket No. 02-0837, involving Central Illinois Light Company ("CILCO"). There, Staff proposed to disallow a *pro forma* adjustment for post-test year plant additions on the basis that CILCO's net plant in service balance at the end of 2002 was lower than the net plant in service balance at the end of 2001, the historical test year. The Commission found that CILCO's *pro forma* adjustments to plant in service should not be approved, because CILCO's net plant in service balance at the end of the test year appeared to be more representative of net plant in service when the rates approved in the proceeding would go into effect. Order in ICC Docket No. 02-0837 at pp. 5-8. The Commission stated that "under the circumstances of this case, where net plant in service shows a consistent declining trend, it is unwise to adopt a post-test year change that fails to account for accumulated depreciation". *Id*. at p. 8.

Peoples Gas' and North Shore's circumstances are not the same as those for the utilities in any of the cases cited by the GCI. Peoples Gas' and North Shore's net plant balances have not been decreasing over time, they have been <u>increasing</u>. Schedules B-5 and B-6 in PGL Ex. SF-1.1 and N. Ex. SF-1.1, and Companies witness Mr. Fiorella's hearing testimony (Tr. 117:2-11, 118:13-14), provide uncontradicted evidence [8]of their increasing net plant balances.[9]

The cases that are on point, therefore, with the instant proceeding are ICC Docket No. 05-0597 (Commonwealth Edison Co., Order dated July 26, 2006) and ICC Docket No. 01-0423 (Commonwealth Edison Co., Interim Order dated April 1, 2002, incorporated in final Order March 28, 2003), which the AG and City-CUB "conveniently" neglected to address in their Initial Briefs. In those cases, the Commission rejected proposed adjustments to Depreciation Reserves by Mr. Effron that are virtually the same as those he proposes in this proceeding, in factual situations that are similar to the factual situations of Peoples Gas and North Shore because they involved a utility with increasing net plant balances, unlike the cases on which GCI relies.[10]

---

[8] The Commission must apply Illinois law governing uncontradicted evidence. "Where the testimony of a witness is neither contradicted, either by positive testimony or by circumstances, nor inherently improbable, and the witness has not been impeached, that testimony cannot be disregarded by the trier of fact." *Bazydlo v. Volant*, 164 Ill. 2d 207, 214 (1995).

[9] Page 14 of the City-CUB Initial Brief also contains the following statement: "The proposed PGL post-test years capital additions are several times the increase in [net] plant ... during the previous 10 years." That statement simply is not true. *Compare* Peoples Gas' <u>unadjusted</u> <u>actua</u>l net plant as of the end of the test year, fiscal year 2006 (PGL Ex. SF-1.1, Sched. B-1, line 3, column [D]) *with* the level approved in its 1995 rate case (Order in ICC Docket No 95-0032, Appendix A, Sched. 1, line 4, column [D].

[10] Both the AG and the City-CUB Initial Briefs contain the same absurd hypothetical, which they use to inaccurately postulate the Utilities' position. AG Init. Br. at 18-21; City-CUB Init. Br. at 13. That hypothetical has no relationship to the actual factuals in these proceedings.

In fact, in ICC Docket No. 05-0597, the AG unsuccessfully argued based on the same IP, AmerenCIPS, AmerenCILCO, and AmerenUE cases. However, ComEd argued there, as do the Utilities here, that those cases factually were not on point. Order in ICC Docket No. 05-0597 at pp. 13-15. The Commission agreed with ComEd in rejecting the AG's proposed adjustment to the Depreciation Reserve, stating in relevant part:

> At issue here is the AG's proposed adjustment to the accumulated reserve for depreciation in order to make the pro forma balance consistent with the pro forma plant in service included in rate base. ComEd contends that the proposal presented by the AG violates Section 287.40 and test year rate making principles. The AG's proposed adjustment does not correlate to any pro forma 2005 capital additions or any plant adjustment proposed by any of the parties. Instead, the AG's proposal merely takes one part of the rate base and moves it one additional year into the future. ComEd argues that the Commission rules and test year ratemaking principles prohibit such an adjustment. The Commission concurs with ComEd as to this issue. Further, the Commission finds that cases presented by the AG to be inapplicable and without merit. The Commission agrees with ComEd's assertion that the effect of the AG's proposed adjustment would be to inappropriately bring the teat year into the future for accumulated depreciation. The Commission rejects the AG's proposed adjustments..

Id. at p. 15.

GCI's proposed adjustments also are improper, for multiple reasons. Peoples Gas and North Shore are using a historical test year. The Utilities provided supporting documentation to parties with respect to their *pro forma* adjustments for post-test year capital additions (amounts of approximately $96 million for PGL and $9 million for NS, <u>reflecting the correct deductions for the Depreciation Reserves</u> and ADIT related to these additions). *E.g.*, Fiorella Reb., NS-PGL Ex. SF-2.0, 8:168 – 9:194 NS Ex. SF-1.1, Sched. B-2; PGL Ex. SF-1.1, Sched. B-2. As a result, the Utilities' *pro forma* adjustments for post-test year capital additions as such are uncontested (NS-PGL Init. Br. at 16-17), and, thus, they provide additional unrefuted evidence of the Utilities' significant growth of plant, although GCI seeks to use them as a pretext for GCI's proposed adjustments to the Depreciation Reserves.

Peoples Gas and North Shore accordingly correctly rejected the proposal of GCI witness Mr. Effron to add another year of depreciation to the Depreciation Reserves. The proposal is applicable to existing plant not related to the plant involved in the *pro forma* adjustments.

The Utilities and Staff agree that, under these circumstances, GCI's proposed adjustments to the Depreciation Reserves violate test year principles by, in effect, trying to change the test year as to existing plant; and, as Staff pointed out, GCI's proposed adjustments also are inconsistent with the Commission's *pro forma* adjustments rules, 83 Ill. Adm. Code § 287.40. Kahle Corr. Reb., Staff Ex. 15.0, 15:301 – 16:345; Fiorella Reb., NS-PGL Ex. SF-2.0, 9:196 – 10:219; Fiorella Sur., NS-PGL Ex. SF-4.0, 9:184-187. GCI's proposed adjustments do not meet the known and measurable standard, as Staff's witness states, and they also are inconsistent with the inflation or attrition language of the *pro forma* adjustments rule, which GCI invoked in opposing the Utilities' now-withdrawn proposed *pro forma* adjustments for non-payroll expenses inflation. NS-PGL Init. Br. at 20, 35-36. See also the quote from the Order in ICC Docket No. 05-0597 above.GCI's Initial Briefs do not mention Staff's testimony on this subject.

GCI's proposed adjustments to the Depreciation Reserves do not correlate to any *pro forma* plant additions or to any plant adjustment proposed by any of the parties. Instead, GCI's proposed adjustments take one part of rate base and move it into the future by adding one year of depreciation. That is improper.

Based on the foregoing, the Companies and Staff have demonstrated that GCI's proposed adjustments to the Depreciation Reserve are not warranted, are not supported by and instead are inconsistent with past Commission decisions, violate test year rate making principles, and are not appropriate under the *pro forma* adjustments rule, 83 Il Admin. Code § 247.40. Thus, they should be rejected.

2. **Derivative Adjustments**

No other party addressed this subject in its Initial Brief.

E. **Cash Working Capital**

As Staff accurately notes, the Companies are willing to utilize the gross lag methodology to calculate their cash working capital ("CWC") requirements. However, Staff misstates the extent of the changes necessary to correct its proposed application of that methodology. Not only do the Companies contest Staff's treatment of: (i) payroll-related capitalized expenditures, (ii) pass through taxes, and (iii) real estate taxes (Staff Init. Br. at 7) -- the Companies also contest the level of revenues and expenses Staff utilized in its calculations. *See* Adams Sur., NS-PGL Ex. MJA-3.0, 7:149-151.

As the Companies and Staff agree, the CWC requirement should be based upon approved revenues and expenses. *See* Adams Reb., NS-PGL Ex. MJA-2.0, 3:48-50 and 4:82 - 5:90; Adams Sur., NS-PGL Ex. MJA-3.0, 5:104-106 and 7:146-148; Staff Init. Br. at 7. Accordingly, recalculation of the Companies' CWC requirements should be based on the revenue and expense levels the Commission adopts in this proceeding, not Staff's adjusted value of the Companies' test year revenues and expenses. *See* Adams Reb., NS-PGL Ex. MJA-2.0, 2:25-31 and 3:48-50; Kahle Corr. Dir., Staff Ex. 3.0, 4:66-70.

Regarding capitalized expenditures, Staff continues to assert that a select group of such capitalized expenditures, *i.e.*, those relating to payroll, should be included in the Companies' CWC analyses. Staff Init. Br. at 7-8. Staff attempts to support its position by asserting:

> when the company incurs a cost like payroll, cash is required regardless of whether the cost is expensed or capitalized. Therefore, the CWC requirement should be computed by applying lead and lag days to the Companies day-to-day cash outlays including capitalized payroll.

Staff Init. Br. at 8; Kahle Corr. Reb., Staff Ex. 15.0, 8:160-162. Staff's assertion, which improperly ignores the distinction between operating expenses and capitalized expenditures, is wrong. Moreover, it directly contradicts Staff's otherwise general recognition of the fact that capitalized expenditures are not considered in CWC analyses.

The purpose of calculating the Companies' CWC requirements is to allow investors to earn a fair return on investments they make to finance the Companies' daily operations (Kahle Corr. Reb., Staff Ex. 15.0, 10:199-200), specifically, monies contributed to facilitate continued operations despite timing differences between the Companies' receipt of revenue and payment of operating expenses. Adams, Tr. at 301:5-10. Thus, CWC requirements are used to adjust rate base. Kahle Corr. Reb., Staff Ex. 15.0, 10:199-200; Adams, Tr. at 301:5-10. Capitalized expenditures, on which investors also are allowed to earn a return, are similarly used to adjust rate base. Adams Reb., NS-PGL Ex. MJA-2.0, 7:148-149 and 9:182-183; Adams Sur., NS-PGL Ex. MJA-3.0, 13:255-56, *see* Kahle Corr. Reb., Staff Ex. 15.0, 8:154-157. Including capitalized expenditures in CWC calculations when they are already otherwise reflected in rate base would allow investors to earn excess returns on such expenses. *See* Adams Reb., NS-PGL Ex. MJA-2.0, 9:182-184.

Also, as explained by Companies witness Mr. Adams, CWC analyses consider the revenues which regulated rates generate and the expenses which are paid from such revenues. *See* Adams Sur., NS-PGL Ex. MJA-3.0, 13:253-259, 14:280-283 and 16:329-330. Proper and accurate application of the gross lag methodology requires a balance between these revenues and expenses such that for every expense there is a corresponding revenue source. Adams Sur., NS-PGL Ex. MJA-3.0, 7:138-140; Adams, Tr. at 299:17-21. The absence of such balance distorts CWC analyses and produces results that do not accurately reflect a company's CWC requirement. Adams Sur., NS-PGL Ex. MJA-3.0, 7:140-141.

Staff's recommendation to include the capitalized portion of payroll and related costs in the Companies' CWC calculations, despite the lack of a corresponding source of revenue, would result in an imbalance and improperly skew the Companies' CWC calculations. Staff's purported justification, namely that capitalized payroll is appropriately included in CWC analyses because capitalized payroll is paid on a schedule similar to the expensed payroll (Kahle Corr. Reb., Staff Ex. 15.0, 9:190-194), simply ignores settled accounting rules that clearly differentiate between the treatment of payroll costs associated with operations and maintenance activities (which should be expensed) and those associated with construction activities (which should be capitalized).

By Staff's own definition, "CWC reflects the amount of cash a company needs to keep on hand to meet its cash operating expenses after taking into account its cash revenues." Kahle Corr. Dir., Staff Ex. 3.0, 3:51-53. Thus, it is operating expenses, as defined by accounting rules, not capitalized expenditures, that are properly considered in CWC analyses. *See* Adams Sur., NS-PGL Ex. MJA-3.0, 14:289-296. Accordingly, Staff's recommendation that the Commission ignore the settled distinction between operating expenses and capitalized expenditures is misguided. *See* Adams Sur., NS-PGL Ex. MJA-3.0, 14:280-283. It serves no legitimate purpose and would constitute poor regulatory policy. That capitalized payroll was included in CWC analyses in recent Ameren cases (Staff's Init. Br. at 7-8) does not alter this conclusion. The excerpts of the Commission order on which Staff relies do not reveal whether the theoretical underpinnings of CWC analyses were fully presented to the Commission or otherwise show that the Commission was advised of all matters relevant to this issue. Kahle Corr. Dir., Staff Ex. 3.0, 10:189-200. Thus, in those cases the Commission's acceptance of Staff's position may simply have resulted from a lack of full information.

Further, according to Staff, CWC analyses should consider all cash outlays. Kahle Corr. Reb., Staff Ex. 15.0, 8:160-162 ("Excluding any cash outlays from the calculation would lead to an incomplete analysis and to an improper calculation of the CWC requirement."). Yet Staff's own analyses do not reflect consideration of all such outlays. Instead, Staff only considers cash outlays comprised of operating expenses and the capitalized portion of payroll-related expenditures. Kahle Corr. Dir., Staff Ex. 3.0, 9:181-184; Kahle, Tr. at 1158:7-13. Thus, despite the fact that there are many other capitalized expenditures that require cash outlays, Staff does not consider them. Adams Reb., NS-PGL Ex. MJA-2.0, 8:171-175; Adams Sur., NS-PGL Ex. MJA-3.0, 8:171 – 9:175; 13:265-269 and 15:303-308; Adams, Tr. at 309:6-12; *see* Kahle, Tr. at 1157:1-4. For example, if the Companies paid cash to purchase a truck and capitalized the outlay, Staff would not argue – despite the cash outlay – that the cost of the truck should be considered in the Companies' CWC analyses. Adams Sur., NS-PGL Ex. MJA-3.0, 14:284-293. Hence, even Staff does not actually believe it is appropriate to include all cash outlays in CWC analyses, and Staff failed to provide any justification for the selective inclusion of capitalized payroll and related costs. Hence, the Commission should reject Staff's contention that CWC analyses should include capitalized payroll expenditures.

Regarding pass through taxes, neither the Companies nor Staff included the expense associated with such taxes in the determination of the Companies' CWC calculations. *See* Adams, Tr. 290:10-291:1 and 291:17-21; Staff Init. Br. at 8-9. However, to reflect the acknowledged timing difference between the Companies' receipt and transfer of funds owing to the various taxing authorities (Kahle, Tr. 1164:9-17), pass through taxes are properly considered in calculating the expense lead times of Taxes Other Than Income Taxes. Adams Sur., NS-PGL Ex. MJA-3.0, 20:409-417; Adams, Tr. at 290:7 - 291:1, 291:17-21, 305:20-22.

Regarding real estate taxes, Staff asserts that they should be separated from other Taxes Other Than Income Taxes because of their relatively long lead time. Staff Init. Br. at 9. However, Staff provides no analysis to support its position, and the fact that all Taxes Other Than Income Taxes are dollar-weighted, which normalizes the affect of relatively long or short lead times (Adams, Tr. at 302:21 - 303:8, 304:17 - 305:3), demonstrates that Staff's position is untenable. The disproportionate weight that would be afforded real estate taxes if the Commission adopted Staff's position provides yet another reason to reject it. Adams, Tr. at 287:18 - 288:3, 303:9-18, 305:4-8.

Staff also contends that real estate taxes should be considered independent of other Taxes Other Than Income Taxes because of the manner in which the Companies treat pass-through taxes. Staff Init. Br. at 9. Staff failed to either explain or support this contention. Accordingly, the Commission should reject it. The Commission should reject Staff's proposed adjustments.

F. <u>Gas in Storage</u>

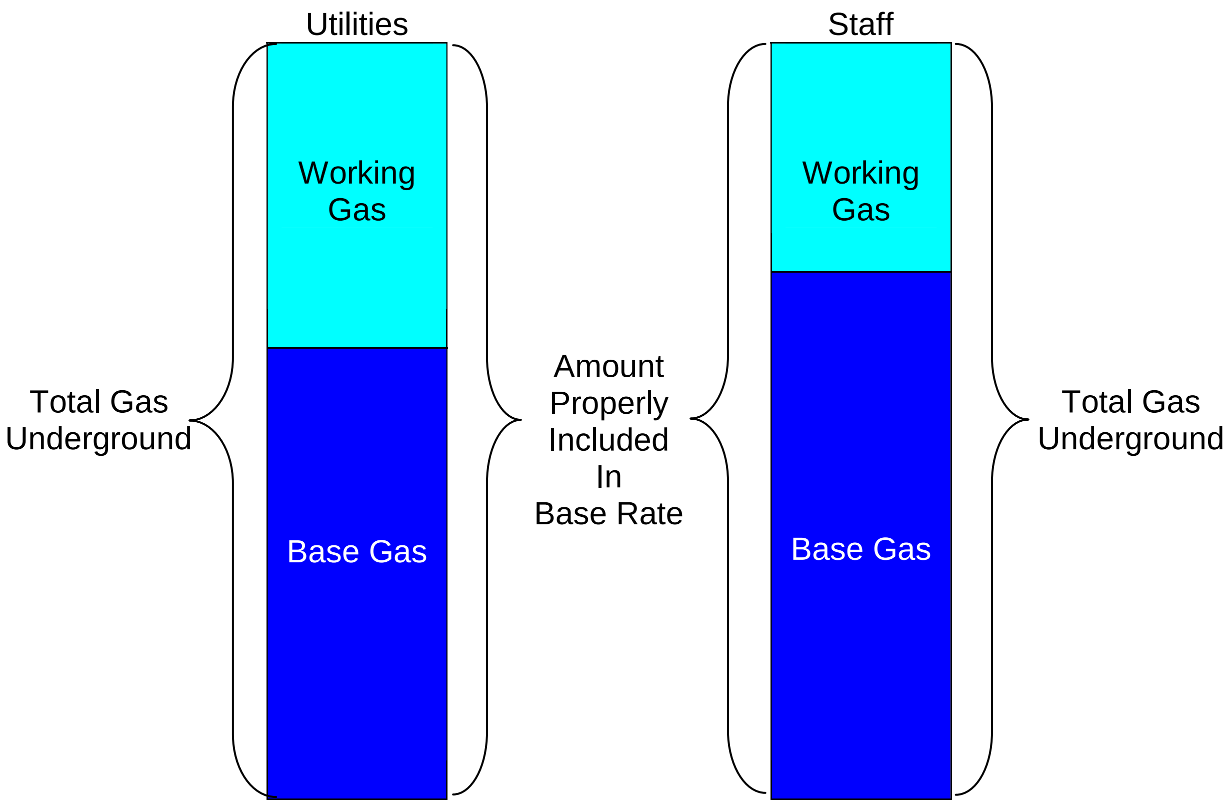
The Utilities correctly calculated their Gas in Storage to be included in rate base. NS-PGL Init. Br. at 27. Staff's proposed adjustments relating to Gas in Storage lack merit and should not be approved, as is discussed below.

1. <u>Working Capital</u>

Staff's position on storage gas working capital is an example of a proposed disallowance based on half the facts. Staff's proposed disallowance looks only at Staff's calculation of what the working inventory number should be. Staff completely ignores the other component of gas stored underground.

It is beyond argument that gas stored underground is one of two things: it is working gas or base gas. Staff admits this. D. Anderson, Tr. at 469:18 - 470:5. Indeed, it is true by definition. *Id*. The working gas is cycled in and out over the course of a year; the base gas stays put. Peoples Gas attempts to do a complete cycle – all the working gas out, and then all injected back in – each year. Zack Reb., NS-PGL Ex. TEZ-2.0, 33:729-732. How much is actually cycled, however, may depend on things like the weather. D. Anderson, Tr. at 473:15-18. A particularly warm winter may cause the Utilities to cycle less. Zack Reb., NS-PGL Ex. TEZ-2.0, 74:1639-1647; *accord* D. Anderson, Tr. at 743:15-474:1.

The Utilities can include in their rate bases both their investment in working gas and their investment in base gas. *E.g.*, PGL Ex. SF-1.1, Sched. B-1, lines 1, 6; 83 Ill. Admin. Code Part 505 (Account 101, incorporating Account 352, non-recoverable base gas, Account 117, recoverable base gas, and Account 164.1, working gas). In other words, since all gas underground is by definition one of these two things, the Utilities get to include in their rate base the cost of all the gas stored underground. There is no dispute as to how much total gas has been injected into underground storage. Zack Sur., NS-PGL Ex. TEZ-3.0, 37:814-823.



This is where Staff is looking at only half the picture. Staff argues that the Utilities have considered too much of the gas to be working gas, and that the appropriate figure is worth $13,549,797 less than what People Gas claimed, and $1,422,722 less than what North Shore claimed. But they ignore the fact – it is mentioned nowhere in their Initial Brief – that if the gas is not working gas, it is base gas, which would also be properly included in rate base. There should be no disallowance here, in the sense that it should have no net effect on total rate base. Staff's "disallowance" is only proper if there is the exact same upward adjustment to the value of the Utilities' base gas included in their rate bases, with the total rate bases unaffected.

2. <u>Accounts Payable</u>

The Utilities correctly did not include any offset for accounts payable in their Gas in Storage figures. NS-PGL Init. Br. at 29-31. Staff's Initial Brief does not alter that Staff's proposed adjustments to impose accounts payable offsets against the Gas in Storage in rate base are unwarranted and should be rejected.

Staff does not dispute that the Utilities paid in full for the Gas in Storage included in their rate bases over a year ago. The evidence of that fact is uncontradicted. NS-PGL Init. Br. at 29-30.[11] That ought to be the end of this issue, because Staff's own witness, in his direct testimony, agreed that storage gas should be included in rate base if it has been funded by the Utilities. *See* Kahle Corr. Supp. Dir., Staff Ex. 3.0 Supp., 2:40-42.

Staff relies on the fact that the amounts of Gas in Storage in the Utilities' rate bases include amounts as of the end of the test year, i.e., <u>as of September 30, 2006</u>, and Staff argues that this means that a portion of the Gas in Storage balances was "financed by vendors" <u>as of September 30, 2006</u>. Staff Init. Br. at 14-15. Staff's brief is a bit imprecise. The amounts in rate base were calculated using the averages of balances in the thirteen months ending on September 30, 2006. PGL Ex. SF-1.1, Sched. B-1, line 6, Sched. B-8.1, column [M]; NS Ex. SF-1.1, Sched. B-1, line 6, Sched. B-8.1, column [M].

In any event, Staff fails to mention that the evidence is uncontradicted that the Utilities pay vendors for storage gas within a maximum of 16 days after receiving the vendors' invoices. NS-PGL Init. Br. at 29-30. Thus, Staff's point that there were accounts payable for Gas in Storage *as of September 30, 2006,* does not mean that the Utilities did not pay for the Gas in Storage in rate base. Again, it is uncontested that the Utilities paid in full for that storage gas over a year ago. All that Staff's point means is that, because the thirteen-month average included the balance for the month ending *on September 30, 2006*, and there were accounts payable as of

[11] Staff's Initial Brief states in part that: "Mr. Kahle's adjustments removed costs which were not financed by investors and were not supported by actual expenditures." Staff Init. Br. at 14. That simply is not an accurate statement of the evidence, as a review of Staff's witness' testimony as well as that of the Utilities will demonstrate.

that date, the Utilities paid off the last amounts owed for a fraction of the Gas in Storage in rate base *no later than October 16, 2006*. That is no reason to disallow any of the costs of the Gas in Storage in rate base.

Staff also overlooks the net balances for storage gas as of September 30, 2006. Peoples Gas' storage gas balance as of September 30, 2006, was $127,746,000 (PGL Ex. SF-1.1, Sched. B-8.1, line 13, column [M]), while the accounts payable as of that date were $26,652,159 (Kahle Corr. Reb., Staff Ex. 15.0, Sched. 15.3 P, p. 2, line 13), yielding a net balance of $101,093,841. Peoples Gas only included $86,667,000 of Gas in Storage in its rate base. Thus, the net balance as of September 30, 2006, is *lower* than the amount in Peoples Gas' rate base. The same is true as to North Shore. *See* NS Ex. SF-1.1, Sched. B-8.1, line 13, column [M]); Kahle Corr. Reb., Staff Ex. 15.0, Sched. 15.3 N, p. 2, line 13. Thus, for this additional reason, the accounts payable balances as of September 30, 2006, do not warrant any disallowance.

Staff's Initial Brief falls back on Staff's witness' theory, raised for the first time in his rebuttal testimony after his direct testimony was refuted, that, after the test year, the Utilities continued and will continue to use and buy storage gas, and that means that vendors will continue to "finance" storage gas, i.e., they will send invoices that are paid by the Utilities within a maximum of 16 days. *See* Staff Init. Br. at 15. That also is no reason to disallow any of the costs of the Gas in Storage in rate base, for which the Utilities paid in full.

Staff makes the point that some of the Gas in Storage included in rate base may have been withdrawn and consumed by customers since the end of the test year. Staff Init. Br. at 15. However, as noted above, the Gas in Storage amounts in the rate bases are based on thirteen-month averages, so they already reflect the test year's injections and withdrawals.

Staff also argues that their proposed adjustments are supported by the treatment of materials and supplies balances. Staff Init. Br. at 15. The Utilities, in their filings, in order to narrow the likely contested issues, chose not to contest materials and supplies accounts payable offsets, but that it not a reason to adopt such as to Gas in Storage. Also, as Staff's exhibits show, for much of the year, the Utilities owe zero accounts payable for Gas in Storage. *See, e.g.*, PGL Ex. SF-1.1, Sched. B-8.1; NS Ex. SF-1.1, Sched. B-8.1; Kahle Corr. Reb., Staff Ex. 15.0, Sched. 15.3 P, p. 2., lines 4-7, Sched. 15.3 N, p. 2, lines 3-7. The fact that, some of the time, the Utilities owe amounts for Gas in Storage, amounts which they pay within no more than 16 days, does not justify disallowances.

Finally, Staff cites Orders in the Utilities' 1995 rate cases and three other rate cases where the Commission approved accounts payable offsets to Gas in Storage balances. Staff Init. Br. at 15-16. Staff's citations do not support Staff's proposed adjustments, because, unlike these proceedings, they each involve future test years where the utilities have not yet paid for the Gas in Storage in their rate bases, and because the use of a future test year mitigates the regulatory lag of an historical test year rate case. Fiorella Supp. Reb., NS-PGL Ex. SF-3.0, 3:43 – 4:73; Fiorella Sur., NS-PGL Ex. SF-4.0, 7:141 – 8:160. The Utilities' Gas in Storage in their rate bases should be approved in full, not offset by accounts payable to deny them recovery on amounts they in fact have paid.

G. <u>OPEB Liabilities and Pension Asset/Liability</u>

Peoples Gas, in calculating its rate base, included neither its net pension asset of $110,000,000 nor its net OPEB liability of $31,570,000 (gross amount $55,563,000). *See, e.g.*, Kallas Reb., NS-PGL Ex. LK-2.0 REV, 12:259 – 13:280; Staff Init. Br., App. A Corr., p. 6, column (k). North Shore, in calculating its rate base, included neither its net pension liability of

$24,000 nor its net OPEB liability of $4,074,000 (gross amount $7,094,000). *See, e.g.*, Kallas Reb., NS-PGL Ex. LMK-2.0 REV, 12:259 – 13:280; Staff Init. Br., App. B Corr., p. 5, column (h). Thus, if the Utilities had included their respective pension asset/liability and OPEB liabilities, which symmetrical treatment would require (Kallas Reb., NS-PGL Ex. LK-2.0 REV, 13:275 – 13:280; Kallas Sur., NS-PGL Ex. LMK-3.0, 3:46-55), then Peoples Gas' rate base would have increased by a net $78,430,000, and North Shore's rate base would have decreased by a net $4,098,000.

Nonetheless, GCI and Staff, in their Initial Briefs, persist in urging the Commission to subtract the Utilities' OPEB liabilities from their rate bases, but to ignore Peoples Gas' pension asset and North Shore's pension liability and their pension contributions. The AG's Initial Brief (at 11-13) and the City-CUB Initial Brief (at 16-18) take that position without even mentioning the Utilities' pension asset/liability and pension plan contributions, much less providing any grounds for disregarding them while including the OPEB liabilities.

Staff claims that subtracting the OPEB liabilities from rate base but ignoring the pension asset/liability is consistent with "ratemaking theory" because "the respective asset/liability was not created with funds provided by shareholders. Because these amounts were not provided by shareholders, shareholders do not need to earn a return on such amounts. (ICC Staff Exhibit 14.0, p. 22)." Staff Init. Br. at 18.

Staff's claim completely ignores the uncontested facts that Peoples Gas' net pension asset reflects that it contributed $15,278,614 to the pension plan during the test year, while North Shore's very small pension liability reflects that it contributed $1,862,247 to the pension plan during the test year. Kallas Sur., NS-PGL Ex. LMK-3.0, 3:55-58. Ratepayers have benefited from those contributions. In calculating their proposed revenue requirements, the levels of pension expense in the test year were reduced by the Utilities' *pro forma* adjustments to reflect the lower levels of pension expense in fiscal year 2007, in the gross amounts of $1,277,000 as to Peoples Gas and $490,000 as to North Shore. Fiorella Dir., PGL Ex. SF-1.0, 27:587-589; PGL Ex. SF-1.1, Sched. C-1, column [D], Sched. C-2, p. 1, line 15, and Sched. C-2.15; Fiorella Dir., NS Ex. SF-1.0, 25:556-558; NS Ex. SF-1.1, Sched. C-1, column [D], Sched. C-2, p. 2, line 15, and Sched. C-2.15.

Staff cites the 2004 and 1995 Nicor Gas rate cases where the Commission approved rate bases that reflected deductions for OPEB liabilities but did not incorporate pension assets. However, as Staff acknowledges, in both of those cases, the Commission found as a matter of fact that the pension assets were created by ratepayer-supplied funds. Staff Init. Br. at 18. The Commission expressly noted in the 2004 case that Nicor Gas acknowledged that it has made no pension plan contributions since the 1995 case. *In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779, p. 22 (Order Sept. 20, 2005) ("*Nicor Gas 2005*"). Similarly, the Order in the 1995 case indicates that the pension balance had gone from negative to positive since the utility's 1987 rate case without any pension plan contributions. *In re Northern Illinois Gas Co.*, ICC Docket No. 95-0219, 1996 Ill. PUC Lexis 204, *20 (Order April 3, 1996) ("*Nicor Gas 1996*"). The Commission's Order in *Nicor Gas 1996* distinguished the Commission's approval of inclusion of a pension asset in rate base in *In re Central Illinois Light Co.*, ICC Docket No. 94-0040 (Order Dec. 12, 1994), on the grounds that there the utility, unlike Nicor Gas, had made pension plan contributions and the inclusion was not a contested issue. *Nicor Gas 1996* at *22. Thus, the *Nicor Gas 2005* and *Nicor Gas 1996* Orders do not support Staff's and GCI's proposed adjustments, because the relevant facts as relied upon by the Commission are not the same, and the 1994 CILCO case supports inclusion.

Staff's witness, unlike Staff's Initial Brief, also cited the Commission's exclusion of a pension asset in *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, pp. 38-40 (Order July 26, 2006) ("*ComEd 2006*"). Pearce Reb., Staff Ex. 14.0, 24:532-535.

In *ComEd 2006*, the Commission's Order on Rehearing of December 20, 2006, at pp. 28-29, did not include the pension asset in rate base, but it allowed the utility to recover a rate of return (based on the cost of long-term debt) on a pension plan contribution that it made shortly after the test year, that was funded by an equity contribution from the utility's ultimate parent company, and that was a major factor in a *pro forma* adjustment to reflect a lower level of pension expense in the year after the test year. The levels fo pension expense also were reduced here. NS-PGL Init. Br. at 32.

Accordingly, GCI's and Staff's position, that OPEB liabilities should be deducted when calculating the Utilities' rate bases, should be rejected. Their proposals are incomplete and one-sided. In the alternative, if the OPEB liabilities are to be deducted, then Peoples Gas' net pension asset of $110,000,000 and North Shore's net pension liability of $24,000 also should be incorporated in the calculation of their rate bases. Finally, further in the alternative, if the OPEB liabilities are to be deducted, then, at a minimum, Peoples Gas' contributions of $15,278,614 and North Shore's contributions of $1,862,247 to the pension plan also should be incorporated in the calculation of their rate bases.

H. ADIT (Derivative Adjustments from Uncontested and Contested Issues)

No other party addressed this subject in its Initial Brief.

III. OPERATING EXPENSES

A. Overview

No other party addressed the subject of overall operating expenses in any substantive detail in its Initial Brief.

B. Uncontested Issues

1. Storage Expenses (Compressor Station Fuel Expenses) (PGL)[12]

No other party addressed this subject in its Initial Brief.

2. Distribution Expenses

a. Non-Payroll Expenses Inflation

The Utilities' initial proposed *pro forma* adjustments for non-payroll expenses inflation, later withdrawn, should not be adopted, because their updates for City of Chicago resurfacing costs and expenses and personal property taxes are uncontested. NS-PGL Init. Br. at 35-36; *see* Staff Init. Br. at 19, 20, 26. No other party addressed this subject in its Initial Brief.

b. Customer Installation Expenses (NS)

Staff's proposed adjustment for North Shore customer installation expenses is uncontested. NS-PGL Init. Br. at 36; Staff Init. Br. at 19-20. No other party addressed this subject in its Initial Brief.

c. City of Chicago Resurfacing Expenses (PGL)

[12] As indicated in their Initial Brief (at 34 and 35 n. 10), the Utilities agreed with or, in order to narrow the issues, accepted the Staff and GCI proposed adjustments discussed in Section III(B)(1) through III(B)(5) and II(B)(7) of the Utilities' Initial Brief. Thus, the Utilities do not agree with all of the rationales given by Staff and GCI for their positions on these subjects in their respective Initial Briefs. The Utilities have not waived their right to pursue these issues in future rate proceedings.

Peoples Gas' final revised figures for City of Chicago resurfacing costs and expenses should be approved. NS-PGL Init. Br. at 36-37. No other party addressed this subject in its Initial Brief.

3. Customer Accounts Expenses (Uncollectible Accounts Expenses)

GCI's proposed adjustments to the Utilities' uncollectible accounts expenses are uncontested, and Staff has withdrawn its proposed adjustments to these expenses. NS-PGL Init. Br. at 37; Staff Init. Br. at 20. No other party addressed this subject in its Initial Brief.

4. Customer Service and Information Expenses

a. "Advertising" Expenses

Staff's proposed adjustments to the Utilities' "advertising" expenses are uncontested. NS-PGL Init. Br. at 37; Staff Init. Br. at 20. No other party addressed this subject in its Initial Brief.

b. Dues and Memberships Expenses (PGL)

Staff's proposed adjustments to Peoples Gas' dues and membership expenses are uncontested. NS-PGL Init. Br. at 38; Staff Init. Br. at 20-21. No other party addressed this subject in its Initial Brief.

5. Administrative & General Expenses

a. Civic, Political, and Related Activities Expenses

Staff's proposed adjustments to the Utilities' "civic, political, and related activities" expenses are uncontested. NS-PGL Init. Br. at 38; Staff Init. Br. at 21. No other party addressed this subject in its Initial Brief.

b. Employee Recreation Expenses

Staff's proposed adjustments to the Utilities' employee recreation expenses are uncontested. NS-PGL Init. Br. at 38; Staff Init. Br. at 21. No other party addressed this subject in its Initial Brief.

c. Corporate Rebill of Income Tax Penalties

Staff's proposed adjustments relating to the corporate rebill of income tax penalties are uncontested. .NS-PGL Init. Br. at 38; Staff Init. Br. at 22. No other party addressed this subject in its Initial Brief.

d. Lobbying Expenses

Staff's proposed adjustments to the Utilities' lobbying costs and expenses are uncontested. NS-PGL Init. Br. at 39; Staff Init. Br. at 22. No other party addressed this subject in its Initial Brief.

e. Executive Perquisites Expenses

Staff's proposed adjustments relating to executive perquisites expenses are uncontested. NS-PGL Init. Br. at 39; Staff Init. Br. at 22-23. No other party addressed this subject in its Initial Brief.

f. Termination Costs (PGL)

Staff's proposed adjustments to Peoples Gas' termination expenses are uncontested. NS-PGL Init. Br. at 39; Staff Init. Br. at 23. No other party addressed this subject in its Initial Brief.

g. **Salaries and Wages Expenses**

Staff's proposed adjustments reflecting the Utilities' corrections of their *pro forma* adjustments relating to salaries and wages are uncontested. NS-PGL Init. Br. at 39[13]; Staff Init. Br. at 23. No other party addressed this subject in its Initial Brief.

h. **Medical and Insurance Expenses**

No other party addressed this subject in its Initial Brief.

i. **Rate Case Expenses**

Staff's proposed adjustments to the Utilities' rate case expenses, and Staff's and GCI's opposition to the recovery of carrying charges on the expenses, are uncontested. NS-PGL Init. Br. at 40; Staff Init. Br. at 24-25. No other party addressed this subject in its Initial Brief.

j. **Franchise Requirements Expenses (NS)**

No other party addressed this subject in its Initial Brief.

k. **PEC Officer Costs and Directors Fees**

Staff's proposed adjustments to Peoples Energy Corporation Officer costs and Directors Fees are uncontested. NS-PGL Init. Br. at 41; Staff Init. Br. at 25. No other party addressed this subject in its Initial Brief.

Staff's Initial Brief further recommends that the Commission's final Order put the Utilities "on notice" that they must comply with General Instruction 14 of the Uniform System of Accounts as to affiliate transactions. (Staff Init. Br. at 25-26) Staff's recommendation is not warranted. Staff witness Ms. Hathhorn, in her direct testimony, made such a proposal. Hathhorn

[13] In preparing their Reply Brief, the Utilities discovered that their Initial Brief (at 39) incorrectly used the word "reducing" instead of the word "increasing" in discussing this subject. *See, e.g.*, Pearce Dir., Staff Ex. 2.0, Scheds. 2.6N, 2.6P.

Dir., Staff Ex. 1.0, 20:417 – 21:433. The Utilities' witness, Ms. Kallas, responded, in rebuttal testimony (Kallas Reb., NS-PGL Ex. LK-2.0 REV, 7:149 – 8:171), stating in part that:

> As a result of the transaction by which Integrys Energy Group, Inc., ("Integrys") became the parent of PEC, the Utilities, PEC, Integrys, and affiliate companies are seeking approval from the Commission in Docket 07-0361 and from three other public utility commissions to provide shared services to the Utilities via a shared services organization, Integrys Business Support, LLC. Integrys, in conjunction with its subsidiaries, is currently designing the processes that will calculate the billings from this shared services organization and the design includes the initial recording of costs to accounts based on the Uniform System of Accounts ("USOA") and the recording of billings from the shared services organization to the appropriate account under the USOA, as if the activity had been performed directly by the Utilities.

Id., 7:161 – 8:171. Staff's witness did not respond in her rebuttal testimony. The Utilities respectfully submit that the final Order need not put them "on notice" of General Instruction 14.

6. <u>Taxes Other Than Income Taxes (Personal Property Taxes)</u>

No other party addressed this subject in its Initial Brief.

7. <u>Income Taxes (Interest Synchronization)</u>

No other party addressed this subject in its Initial Brief.

C. <u>Contested Issues</u>

1. <u>Storage Expenses</u>

a. <u>Crankshaft Repair Expenses (PGL)</u>

Peoples Gas' test year operating expenses included $546,000 for repair expenses for an unusual crankshaft failure on a compressor. NS-PGL Init. Br. at 41-42; Staff Init. Br. at 26-27. GCI proposed that Peoples Gas should be allowed to recover these expenses, but only on an amortized basis over a four year period, which meant that the test year amount of $546,000 would be reduced by $410,000 (3/4ths), i.e., to $136,000 (1/4th), in calculating the revenue requirement. Effron Dir., GCI Ex. 2.0 Rev., 32:722 – 33:738 and Sched. C-2 (Peoples Gas). In order to narrow the contested issues, Peoples Gas accepted GCI's proposed adjustment, and reflected that adjustment in its rebuttal and final revenue requirement calculations. Fiorella Reb., NS-PGL Ex. 2.0, 4:82-90, 5:111, 12:251-261; NS-PGL Ex. SF-2.5P, column [D]; NS-PGL Ex. SF-2.6P, p. 3, column [E]; NS-PGL Ex. SF-4.3P, column [C]. No party denies that the expenses were prudent, reasonable, and needed. Amortization is fair and reasonable.

Staff still proposes to completely deny any recovery of the $546,000, which would mean eliminating the amortized amount of $136,000. Staff Init. Br. at 26-29. Staff makes the point that the crankshaft failure was a very unlikely event (*id.* at 27-28), but that does not support denying recovery of these prudent, reasonable, and needed expenses. Moreover, given the broad scope of Peoples Gas' operations, it is likely to experience different non-recurring events each year. Fiorella Sur., NS-PGL Ex. SF-4.0, 10:214-216.

The amortized amount of $136,000 is fair and reasonable, as recommended by GCI's witness and supported by Peoples Gas. This amount should be allowed to be recovered, for the reasons stated in the Companies' Initial Brief (at 41-42).

b. <u>Hub Services (PGL)</u> (To be addressed in Section V, below)

2. <u>Customer Accounts Expenses (Collection Agency Fees)</u>

Staff proposes to disallow collection agency fees in the gross amounts of $1,770,000 and $76,000 as to Peoples Gas and North Shore, respectively (Staff Init. Br. at 29-31), but Staff has not fairly and accurately stated all of the relevant facts. Staff's proposal is without merit.

In calculating their revenue requirements, the Utilities appropriately used three-year averages of the collection agency fees they incurred in fiscal years 2003 through 2005, rather than the level in the test year, fiscal year 2006, because the latter was abnormally low due to the

2006 Gas Charge settlement. NS-PGL Init. Br. at 42-43. The dramatic effect of the settlement on the test year level of the fees is shown by the charts on page 43 of their Initial Brief.

Staff claims that the test year levels are more likely to recur in the period in which the rates set in this case will be in effect than the three-year average used by the Utilities. Staff Init. Br. at 29. The facts do not back up, and instead are contrary to, that claim.

Staff points to the test year level and the partial data available for 2007. Staff Init. Br. at 30. However, the rates to be set in this case will go into effect in 2008. Moreover, Staff cannot consistently take the position that the rates to be set in this case will only be in effect for a short period. Staff took the position that rate case expenses should be amortized over a five-year period, on the grounds that that was a more likely interval until the Utilities' next rate case, and, in order to narrow the issues, the Utilities accepted that proposal. *Id*. at 24.

Staff's witness, in claiming that the test year level is more likely to recur than the average of the three preceding years, relies on a data request response of the Utilities (Hathhorn Reb., Staff Ex. 13.0, 8:182 – 10:205), but, while that response provides reasons for the test year and 2007 levels being abnormally low, it does not state or support her inference that those low levels should be expected to recur in 2008 or later years. NS-PGL Cross Hathhorn Ex. 6. The evidence shows that the three-year average of fiscal years 2003 through 2005 is more likely to recur in the years in which the rates being set will be in effect. NS-PGL Init. Br. at 44.

Moreover, Staff's position, which calls for using an abnormally low test year value here, is inconsistent with Staff's position calling for normalizing the level of injuries and damages expenses, discussed in Section III(C)(3)(a) of this Reply Brief, *infra*.

Finally, Staff claims that the Utilities' position somehow is in conflict with the "intent" of the provision of the Gas Charge settlement under which they agreed forgive certain debt owed in

2005 and not pursue collection of those amounts (Staff Init. Br. at 30, 31), but that is wrong. The evidence is uncontradicted that the Utilities are not seeking to collect even one penny of the forgiven amounts, directly or indirectly, rather they are trying to include a normal level of collection agency fees in their revenue requirements used to set rates that will go into effect in 2008, and those fees do not involve the forgiven amounts. Kallas Reb., NS-PGL Ex. LK-2.0 REV, 6:123-133; Kallas Sur., NS-PGL Ex. LMK-3.0, 3:67 – 4:78. Staff's proposed adjustments are unwarranted and should be rejected.

3. <u>Administrative & General Expenses</u>

a. <u>Injuries and Damages Expenses</u>

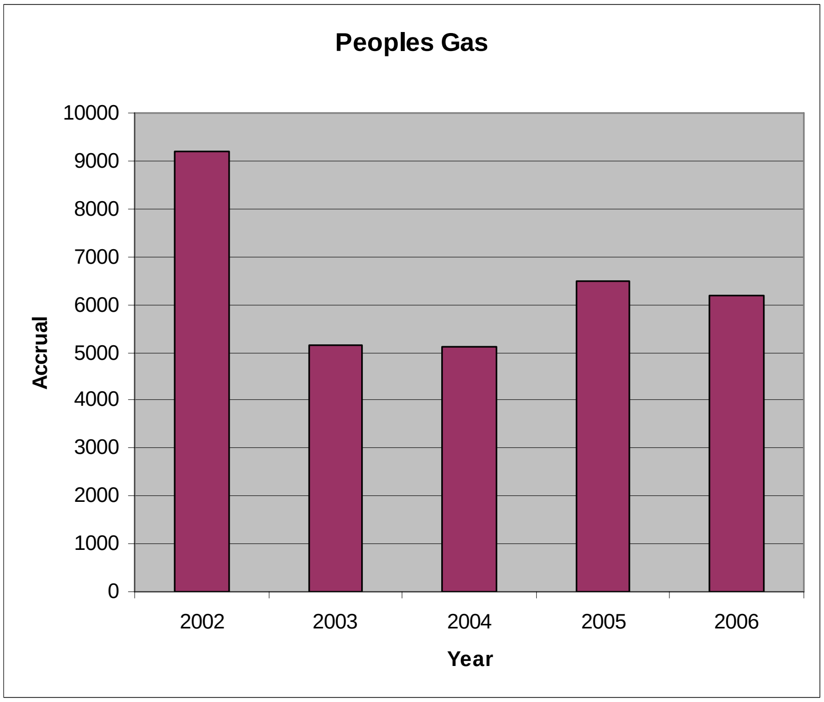
North Shore and Peoples Gas used the correct levels of injuries and damages expenses in calculating their revenue requirements. North Shore appropriately used its unadjusted test year level. Fiorella Dir., NS Ex. SF-1.0, 18:393 – 20:439; NS Ex. SF-1.1, Sched. C-1, lines 13-14; Sched. C-2. Peoples Gas appropriately used its test year level, adjusted for a highly unusual credit recorded in fiscal year 2006 relating to a major claim that occurred in fiscal year 2002. Fiorella Dir., PGL Ex. SF-1.0, 19:420 – 21:466, 23:496, 31:673-679; PGL Ex. SF-1.1, Sched. C-1, lines 13-14, Sched. C-2, p. 2, line 30, and Sched. C-2.3.

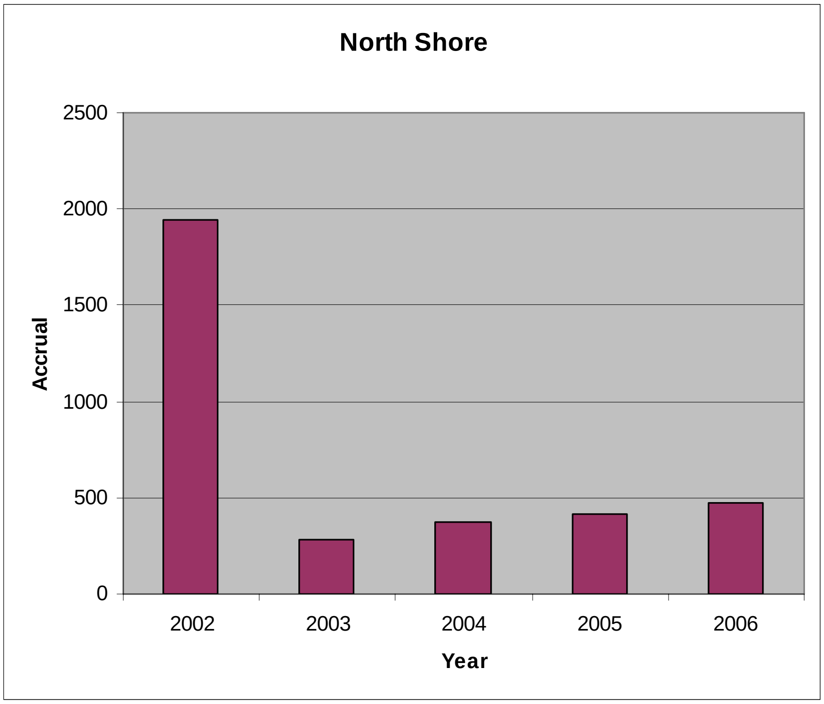
Staff claims that: "Since the annual accruals can vary greatly from one year to the next, it is more appropriate to normalize the expense for ratemaking purposes." Staff Init. Br. at 32. Staff's claim is based on the levels of the accruals in the five year period ending with the test year. *Id*. Any reasonable review of the levels shows, however, that Staff's claim is incorrect.

Staff's exhibits (Griffin Reb., Staff Ex. 16.0, Sched. 16.2 P, p. 2, lines 1-5, and Sched. 16.2 N, p. 2, lines 1-5) show that the levels for Peoples Gas and North Shore for fiscal years 2002 through 2006 were as follows:

Injuries and Damages Accruals		
	Peoples Gas	North Shore
FY 2002	$9,185,000	$1,940,000
FY 2003	$5,147,000	$279,000
FY 2004	$5,124,000	$371,000
FY 2005	$6,502,000	$415,000
FY 2006	$6,192,000	$477,000

That data results in the following charts:





The levels shown in these charts obviously do not support "normalization". Only Staff's inclusion of fiscal year 2002 data yields any large variance. Yet, Staff's witness provided no factual basis for choosing a five year period.

Moreover, Staff's position, calling for normalizing the level of injuries and damages expenses, is inconsistent with Staff's position, which calls for using an abnormally low test year value for collection agency fees, discussed in Section III(C)(2) of this Reply Brief, *supra*.

In addition, Staff's witness's methodology is arbitrary and problematic. He proposed to set the levels for these expenses using the following methodology:

(1) calculate the five year average of the accruals for these expenses over the period of fiscal years 2002 through 2006,

(2) calculate the five year average of actual payouts over that period,

(3) divide the latter by the former to develop a percentage, and

(4) multiply that percentage times the fiscal year 2006 accrual to obtain the allowed level to be included in the revenue requirement.

See Griffin Reb., Staff Ex. 16.0, Scheds. 16.2 P and 16.2 N.

Staff's witness cited (Griffin Dir., Staff Ex. 4.0, 8:136 – 9:159) the Commission's Order in *In re Central Illinois Light. Co.*, et al., ICC Docket Nos. 06-0070, 06-0071, 06-0072 Cons., pp. 48-49 (Order Nov. 21, 2006) ("*CILCO 2006*"), but there, Staff looked at five years of data, and then discarded, in each instance, data from one year that Staff considered unrepresentative, resulting in Staff's proposing four-year averages. Consistency of proposals on Staff's part would have resulted in Staff not using the fiscal year 2002 data here. Staff claims it has not been shown that fiscal year 2002 is an "outlier" (Staff Init. Br. at 33), but the data above refute that claim.

Under Staff's methodology, however, had Staff chosen a four-year period (i.e., excluded the fiscal year 2002 data) or a three-year period, then it would have generated higher levels, not lower levels, for each utility. Kallas Sur., NS-PGL Ex. LMK-3.0, 5:93-100. Thus, there is no valid factual basis for the proposed disallowances.

Staff argues that *CILCO 2006* supports Staff's use of the five-year period, but Staff did not provide the data that was used in that case to determine that normalization was appropriate in the first place. Moreover, there, the Commission approved the AG's proposed use of a five year average of the payouts, not the more complex formula Staff proposes here. Had Staff used that methodology, then its proposed disallowances would be smaller, because Staff would propose a level of $5,443,200 for Peoples Gas, not $5,242,000, and $545,000 for North Shore, not $373,000. *See* Griffin Reb., Staff Ex. 16.0, Sched. 16.2 P, p. 2, line 6, column (c) (divide by 5) versus line 9, and Sched. 16.2 N, p. 2, line 6, column (c) (divide by 5) versus line 9. However, Staff's proposed adjustments should be rejected in their entirety, because it is clear that normalization is not warranted in the first place, and that Staff's arbitrary choice of methodology has no valid reason for being chosen over methodologies that would increase, not decrease, the expense levels included in the revenue requirements.

b. Incentive Compensation Expenses

(i) The Utilities Are Entitled to Recover All of the Challenged Incentive Compensation Costs

Peoples Gas and North Shore, in their Initial Brief, carefully and in detail reviewed the evidence, prior Commission decisions, and the law applicable to their incentive compensation costs and expenses. The Companies showed that there is not only compelling but uncontradicted evidence that these costs and expenses in their entirety are prudent, reasonable in amount, and benefit customers by serving to attract and retain a sufficient, qualified, and motivated work force, although Staff and GCI take the position that that benefit to customers "does not count". NS-PGL Init. Br. at 47-50, 53. They also pointed out that, to apply the superimposed special standards for recovery that Staff and GCI advocate based on several past Commission decisions, is inconsistent with the basic legal principle that rates must allow the utility to recover costs prudently and reasonably incurred. *Id*. at 50. The Utilities also discussed the specific facts regarding each of the plans in question, showing that there should be no disallowances under each plan, and, in the alternative, showing how much of the challenged amounts was "operational" (e.g., based on controlling operations and maintenance ("O&M") expenses or customer satisfaction criteria) or "non-financial" and, therefore, even under Staff's and GCI's special standards, should be allowed. *Id*. at 50-53.

The respective Initial Briefs of Staff (at 34-40), the AG (at 14-17), and City-CUB (at 18-21) each argue for complete disallowance of all of the Companies' incentive compensation program costs and expenses, although Staff tacitly admits, as discussed further below, that some recovery should be allowed. Their briefs do not justify their positions.

None of their briefs tries to deny that the evidence is uncontradicted that the challenged amounts are prudent and reasonable. None tried to deny that the evidence is uncontradicted that in fact the incentive compensation programs benefit customers by serving to attract and retain a sufficient, qualified, and motivated work force. Instead, they argue that it is not a "legitimate" benefit or does not count given past Commission decisions. Staff Init. Br. at 36; AG Init. Br. at 15. That does not change the fact that it benefits customers.[14]

Nor do any of their briefs provide any cogent and persuasive explanation of why incentive compensation program costs and expenses, if prudently and reasonably incurred, can or should be disallowed under the applicable law. Staff, the AG, and City-CUB simply and incorrectly treat as conclusive the standards imposed by the past Commission Orders they cite.[15]

Out of Staff's, the AG's, and City-CUB's Initial Briefs, only Staff's brief attempts to discuss any of the facts in any meaningful detail, and Staff's brief seriously errs. The AG's Initial Brief on this subject consists of arguments regarding the applicable standards, cites and quotes from prior Commission decisions, and very superficial references to the witnesses who

---

[14] A Commission order is subject to reversal if, among other things, it is not supported by substantial evidence in the record or is not based exclusively on the evidence in the record. 220 ILCS 5/10-103, 10-201(e)(iv)(A); *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 120-21, 131 (1995). While Commission findings of fact generally are presumed to be correct, 220 ILCS 5/10-201(d), they are subject to reversal if, among other things, they are not supported by substantial evidence or contrary to the manifest weight of the evidence. 220 ILCS 5/10-201(e)(iv)(A); *Citizens Utilities Co. of Illinois v. Illinois Commerce Comm'n*, 124 Ill. 2d 195, 206 (1988). Where the facts are not in dispute, and the issue is one of law, the Commission's determinations are not binding or presumed to be correct. *Illinois Indep. Tel. Ass'n v. Illinois Commerce Comm'n*, 183 Ill. App. 3d 220, 228-29 (4th Dist. 1988); *Citizens Utilities Co. of Illinois v. Illinois Commerce Comm'n*, 153 Ill. App. 3d 28, 31-32 (3d Dist. 1987).

[15] Commission orders are not legal precedents, nor are they *res judicata*. *E.g., United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill. 2d 1, 22-23 (1994); *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d 509, 513, (1953).

testified on this subject. AG Init. Br. at 14-17. City-CUB's Initial Brief does nothing more than discuss the standards they espouse and make the raw claim that the Utilities did not meet those standards. City-CUB Init. Br. at 18-21.

Staff's Initial Brief skips back and forth somewhat between Staff's different arguments for disallowances. Staff seems to make four general arguments: (1) the plans are discretionary; (2) the plans are "largely" "financial" and the Utilities have not proven that ratepayers benefit when benefits are limited to the benefits that Staff considers legitimate; (3) in the future the goals might not be met and thus the Utilities would not pay out under the plans; and (4) past Commission orders support disallowance in these circumstances. Staff Init. Br. at 34, 36.

Staff's first argument lacks merit. The Utilities have presented detailed evidence regarding the design of each of the incentive compensation programs under which the costs and expenses at issue were incurred and paid out, as well as how the accruals compared to the payouts in the test year. *See, e.g.,* NS-PGL Init. Br. at 50-53. The Utilities also presented uncontradicted evidence regarding their incentive compensation program design in 2007 and going forward. Hoover Reb., NS-PGL Ex. JCH-1.0, 9:175 – 11:209.

Staff's second argument also is incorrect, for three different reasons. First, as noted above, Staff's theory that the benefits of attracting and maintaining a sufficient, qualified, and motivated work force is not a "legitimate" benefit lacks any factual basis and instead is based on the unreasonable theory that if the Commission has not found it to be a benefit then it can be disregarded. Second, the Utilities' Initial Brief carefully went through each of the plans and showed, using Staff's criteria, which portions were "financial", which were "operational", and which were "non-financial". NS-PGL Init. Br. at 50-53. Finally, Staff's theory that controlling O&M expenses also does not count as benefiting customers (Staff Init. Br. at 37) is specious and wrong. The Utilities presented uncontradicted evidence that incentive compensation programs were a contributing factor in the Utilities' significantly reducing O&M expenses below target levels. NS-PGL Init. Br. at 48. Several Commission decisions have recognized that incentive compensation programs that reward employees for lowering operating expenses benefit customers. *Id*. While Staff's witness suggests that controlling and reducing costs does not benefit customers, that is illogical and inconsistent with Commission orders that she herself relies upon, which talk about, among other things, cost savings as a customer benefit that justifies recovery. *Id*.

Staff's third argument is rank conjecture supported by no data. The history of payouts under the programs negates any such speculation. *See, e.g.*, Hoover Reb., NS-PGL Ex. JCH-1.0, 9:166-174.

Staff's fourth argument is not an independent argument at all, it simply is the claim that Staff's other arguments are supported by past Commission decisions. None of Staff's general arguments for its proposed disallowances has merit. GCI's arguments add nothing. GCI's and Staff's proposed adjustments should not be approved.

(ii) <u>The TIA Plan</u>

The Companies' Initial Brief showed that all of the costs and expenses of the Team Incentive Award ("TIA") should be allowed for recovery and, in the alternative, that the specific amounts that are "operational" – i.e., that meet Staff's and GCI's standards – should be allowed. NS-PGL Init. Br. at 50-51.

Staff's Initial Brief (at 34-35) tacitly acknowledges that, even under Staff's standards, Peoples Gas should be allowed to recover $282,486 and North Shore should be allowed to recover $26,368 under the TIA plan. That is because Staff cannot really argue that the associated customer satisfaction criterion does not meet its standards for recovery. Staff opposes the other operational amounts based solely on the theory, refuted above, that controlling O&M expenses does not count as a customer benefit. Staff Init. Br. at 37. Thus, the entire TIA plan amounts, or, in the alternative, the operational amounts calculated by the Companies, should be approved.

(iii) <u>The IPB Plan</u>

The Companies' Initial Brief showed in detail why the costs and expenses incurred under the Individual Performance Bonus ("IPB") plan should be allowed in full, because they are not "financial" and are based on individual performance. NS-PGL Init. Br. at 51-52.

Staff's opposition once again is based on general claims that have no substance (*see* Staff Init. Br. at 38), except Staff makes one meaningful factual point, which is that the IPB Plan was only in place during the test year (*id.*). Staff argues that the later point shows that the plans are "discretionary". However, that general point was refuted by the Utilities, as noted above. Given the continuity of plans, approaches, accruals, and payouts, the fact that the IPB plan in particular was only in place during the test year is not a reason for a disallowance.

(iv) <u>The STIC Plan</u>

The Utilities' Initial Brief showed both the "financial and the "operational" components of the "STIC" plan. NS-PGL Init. Br. at 52. Staff's Initial Brief does not differ as to the facts on this plan, only as to the conclusions to be drawn from them. Staff Init. Br. at 37-38.

(v) <u>The Affiliate Charges</u>

See NS-PGL Init. Br. at 52. Staff's Initial Brief discussed these costs and expenses only in a conclusory manner. *See* Staff Init. Br. at 38-40.

(vi) <u>Restricted Stock and Performance Shares</u>

See NS-PGL Init. Br. at 52-53. Staff's Initial Brief discussed these costs and expenses only in a conclusory manner. *See* Staff Init. Br. at 39-40.

The Commission should approve all of the challenged incentive compensation costs and expenses. In the alternative, the Commission should allow recovery of the specified operational and non-financial expenses discussed above, including, at a minimum: (1) Peoples Gas and North Shore should be allowed to recover $1,009,240 and $94,204, respectively, under the TIA plan; and (2) $625,791 and $53,107 under the IPB plan, respectively.

4. Invested Capital Taxes

Staff and the Utilities agree that invested capital taxes need to be recalculated based on the final approved rate increases (the increases in base rate revenues) when setting the Utilities' final approved revenue requirements, and they agree over how to perform those calculations. NS-PGL Init. Br. at 54-55; Staff Init. Br. at 40. Only GCI makes any objection here.

GCI first complains that the amounts for invested capital taxes included in the Utilities' proposed revenue requirements reflect the Utilities' proposed rate increases. *See* AG Init. Br. at 17; City-CUB Init. Br. at 21. That is absurd. Invested capital taxes are a derivative adjustment. Staff Init. Br. at 40. The correct way for a party to calculate a derivative adjustment is to start with its proposed positions on the merits. The Utilities and Staff have made clear that the final amounts need to be recalculated based on the final approved rate increases.

GCI's only other objection is their witness Mr. Effron's rank speculation about increases in dividends that might affect these taxes. AG Init. Br. at 25. The Utilities' Initial Brief pointed out that Mr. Effron cited no factual basis for his speculation, there is none, and a disallowance based on that speculation would be improper. NS-PGL Init. Br. at 54-55. Moreover, the Utilities' proposed capital structure is uncontested. NS-PGL Init. Br. at 61. Thus, calculating these taxes based on different assumptions about dividends is not required. *See, e.g.,* Staff Cross Fiorella Ex. 2. The Commission should calculate the final level of these taxes, in the manner which the Utilities and Staff agree is correct, based on the final approved rate increases.

5. **Adjustment to Remove Non-Base Rate Revenues and Expenses (Schedule Presentation Issue)**

The Utilities incorporate their Initial Brief (at 55).

D. **Derivative Adjustments from Uncontested and Contested Issues**

No other party addressed this subject in its Initial Brief.

IV. **RATE OF RETURN**

A. **Capital Structure (Uncontested)**

The parties' initial briefs confirm that there is agreement that Utilities' capital structures for ratemaking purposes should be 56% common equity and 44% long-term debt. *See* NS-PGL Init. Br. at 61; Staff Init. Br. at 41-44. No other party addressed this issue.

B. **Cost of Long-Term Debt (Uncontested)**

The parties' initial briefs confirm that there is agreement on the Utilities' costs of long-term debt as presented in the Utilities' Initial Brief. *See* NS-PGL Init. Br. at 62-63; Staff Init. Br. at 44-51. No other party addressed this issue.

C. **Cost of Common Equity**

1. **Peoples Gas and 2. North Shore (Combined Discussion)**

The Roles of Objectivity, Subjectivity, and Investor Expectations in Determining a Utility's Cost of Equity.

In CUB-City's view of the world, only they are capable of "objectively" divining the Utilities' ROE, which is by definition unknowable. Anyone who disagrees with them is biased and has subjectively manipulated the financial models to reach a predetermined goal. By impugning the character of their adversaries, CUB-City hope to mask their own subjective use of the financial models. They want the Commission to ignore the ROEs recently granted gas utilities by this Commission and others, because when those returns are compared to the 8% and lower returns advocated by CUB-City, it exposes the lengths to which CUB-City's witness, Mr. Thomas, went to derive artificially low ROEs for the Utilities.

The fact that there is precious little in cost of equity estimation that is objective in the sense that the analyst need not exercise judgment. The models require various inputs that are derived from objective data, but the analyst must pick and choose from that data. The models themselves are criticized for having built-in biases, in that they will produce excessively high or low estimates depending on market conditions. CUB-City can only admit that "no estimation methodology is entirely objective." CUB-City Init. Brief at 36. Only Mr. Moul is willing to say what everyone in the room is thinking: "And I think any cost of equity witness would be quick to tell you that there's a certain amount of subjectiv[ity] in applying any of the models; but, nonetheless, all of them produce an answer." Moul, Tr. at 1079:16-19.

Acknowledging that there is subjectivity involved in applying the financial models is a far cry from the accusation CUB-City levels against Mr. Moul – that he manipulated the models to achieve a desired result. CUB-City Init. Br. at 36. Nothing could be further from the truth. Nowhere in Mr. Moul's direct testimony will the Commission find any reference to the returns authorized by it or other state commissions, because Mr. Moul did not consider them in his application of the models. Only in rebuttal testimony did he present evidence of other returns, and that was for the purpose of proving that his results were consistent with investor applications and that the ROEs proposed by Staff and CUB-City were not. Moul Reb., NS-PGL Ex. PRM-2.0, 3:60-4:75.

By contrast, Mr. Thomas' subjective application of the financial models to achieve lower cost of equity results is manifestly apparent. For example, Mr. Thomas proposed the use of "internal" (i.e., lower) growth rates in the DCF model because, he argued, analyst forecasts are upwardly biased. Thomas Dir., CUB-City Ex. 1.0, 15:326-26:602. As Mr. Moul testified, the proper and accepted focus of the DCF model is earnings per share growth. Moul Dir., PGL Ex. PRM-1.0, 16:353-17:361; *see also* Moul Reb., NS-PGL Ex. PRM-2.0, 25:545-27:602. Ms. Kight-Garlisch noted that the studies Mr. Thomas cited compared analyst forecasts to achieved growth, which is irrelevant to the task at hand, namely to determine "what investors' true growth expectations are." Kight-Garlisch Reb., Staff Ex. 18.0, 17:345-346. For another example, Mr. Thomas advocated a much lower equity risk premium for the CAPM model than either Mr. Moul or Ms. Kight-Garlisch. Thomas Dir., CUB-City Ex. 1.0, 54:1324-1333. Ms. Kight-Garlisch pointed out that the research cited by Mr. Thomas "represents various academics' opinions of the equity risk premium investors should expect, which is not necessarily the same as what the investors truly are expecting." Kight-Garlisch Reb., 18.0, 20:407-409. In yet a third example, Mr. Thomas proposed the use of unadjusted betas in the CAPM model, arguing that the use of adjusted betas created an upward bias in the results. To the contrary, the Commission has previously ruled that the use of unadjusted betas result in a <u>downward</u> bias in the results. *See* NS-PGL Init. Br. at 80.

In each of these examples, Mr. Thomas proposed approaches that diverge from well-accepted applications of the financial models and result in lower ROEs. Determining what investors <u>should</u> expect is much more subjective than determining what investors <u>do</u> expect. As the Utilities have shown, the approach is also contrary to law. In setting the cost of equity, the Commission follows the financial principles that are used by sophisiticated investors, and seeks to replicate what the investor is demanding, not what the investor should demand. NS-PGL Init. Br. at 57-58.

The proof is in the pudding. Mr. Thomas' recommended ROEs are so far below any return authorized by this Commission for a gas utility in the last 30 years, and so far below any return granted a gas utility by any state commission in recent years, that they do not merit serious consideration. There could be no better proof of subjective intent than that. What more objective guidepost for utility ROEs could there be than those actually authorized? Mr. Thomas' assertion that state commissions have been systematically authorizing excessive returns for decades is beyond belief. It is Mr. Thomas' returns that are the outliers, not everyone else's.

There is no principled basis for objections by Staff and CUB-City to the Commission's consideration of ROE determinations in other gas utility rate cases (including this Commission's own determinations), or other information available to and relied upon by sophisticated investors. Mr. Moul suggested that the Commission do so when determining the utility's ROE within in the range of returns produced by proper applications of the models. Referencing such information is fully consistent with, if not mandated by, the Commission's task of replicating the expectations of sophisticated investors and making estimates of what the sophisticated investor is demanding.

A review of recent gas utility returns will quickly show that the ROE recommendation of Staff and CUB-City are far lower than what any sophisticated investor would expect or demand in today's market. Investors in today's market are expecting returns for gas utilities in the mid-tens to the low-elevens. Moul Reb., NS-PGL Ex. PRM-2.0, 3:60 – 4:75. Mr. Moul's financial model results average to 11.06%, which is certainly within this range, if at the higher end of the range. Staff's sub-10% position and CUB-City's 8% and lower recommendations are not even in the ballpark of investor expectations.

<u>Staff's Inconsistent Consideration of "Financial" Risk</u>

The Utilities' initial brief identified several inconsistencies in Staff's ROE analysis. None is more glaring than Staff's position on the consideration of "financial" (as opposed to "operational") risk in the financial models.

Mr. Moul took both financial and operational risks into account in assembling the proxy group of utilities that <u>all</u> of the cost of equity witnesses used to run their models. He also employed a financial leverage adjustment in the DCF and CAPM models to offset the mismatched application of the market-based cost of equity generated by the models to the proxy group's book value common equity structures used for ratemaking purposes. This adjustment ensures that the market models produce costs of equity that reflect the actual financial risk reflected by the capital structure assumed for rates, and that the authorized ROE generates earnings that correspond to that risk.

Staff rejects Mr. Moul's financial leverage adjustment out of hand, asserting that it has no basis in financial theory. Yet Ms. Kight-Garlisch relied on the exact same financial theory – the Modigliani-Miller principle that the more debt in a firm's capital structure, the higher its cost of equity –for her "financial risk" adjustment to her financial model results. Kight-Garlisch Reb., Staff Ex. 18.0, 4:74-79.

Both Staff and CUB-City mischaracterize Mr. Moul's financial leverage adjustment. It is <u>not</u> a "market to book" adjustment, as these parties repeatedly claim. Staff Init. Br. at 59, 61, 64, 65 (twice), 68; CUB-City Init. Br. at 28, 30, 32, 33, 41, 42, 43. Such an adjustment takes the financial model result and multiplies it by the utility's market-to-book ratio. Staff Init. Br. at 64. As shown below, the formulas employed by Mr. Moul are entirely different. Nor is Mr. Moul's financial leverage adjustment intended to maintain a market-to-book ratio greater than one, which is the type of adjustment the Commission rejected in *In reCentral Illinois Light Co, et al.*, ICC Docket 06-0070, 06-0071 (Cons.), at p. 141 (Order Nov. 21, 2006) ("*Ameren*").

For these reasons, Staff unfairly criticizes Mr. Moul's financial leverage adjustment as being "based on the incorrect notion that utilities should be authorized rates of return on equity in excess of the investor-required return whenever their market values of common equity exceed book value." Staff Init. Br. at 61. To the contrary, Mr. Moul's financial leverage adjustment is required whenever market values of equity vary significantly from book values (in either direction), so that the authorized return applied to the book value capital structure of the utility truly represents the investor-required return.

Mr. Moul's financial leverage adjustment is based on the Modigliani-Miller principle that there is an direct relationship between the amount of debt, or financial risk, in a firm's capital structure and its cost of equity. The more debt and financial risk, the higher the firm's cost of equity. It is undisputed (and undisputable) that the costs of equity produced by the financial models are based on the market value capitalizations of the utility sample. The proxy group's market value capitalizations contain more equity and less financial risk than its book value capitalizations used for ratemaking purposes, which contain less equity and more financial risk. To apply a market-based cost of equity to a book value capital structure mismatches the financial risks reflected by the two. If an ROE that is based on a lower amount of financial risk is applied to a utility's book value capital structure, the utility's earnings will by definition be insufficient to allow the utility to achieve the authorized return. Moul Dir., PGL Ex. PRM-1.0 REV, 25:539 - 544; Moul Dir., NS Ex. PRM-1.0 REV, 25:527-532

To correct this mismatch, Mr. Moul employs an adjustment to the financial models' market-based costs of equity to reflect the higher financial risk of the proxy group's book value capital structures. *PGL id.*, 28:610-612; *NS id.*, 27:595-593. In this case, the overall adjustment to the proxy group's cost of equity is <u>52 basis points</u>. *PGL id.*, 28:612-616; *NS id.*, 27:593 – 28:600; PGL Ex. PRM-1.13C, 12:343-14:386; NS Ex. PRM-1.13C, 13:345-15:388.[16] By contrast, the "financing flexibility" and "equilibrium market/book ratio" adjustments proposed by Ameren last year totaled <u>140-260 basis points</u>. *Ameren*, at p. 115. Mr. Moul's financial leverage adjustment is not intended to maintain a market-to-book ratio, but rather is a modification to costs of equity derived from market value capitalizations with less financial risk when those costs of equity are applied to book value capitalizations with more financial risk.

It is true that if the proxy group's market value capitalizations are higher than their book value capitalizations, then the result of Mr. Moul's financial leverage adjustment will be to increase the cost of equity. By the same token, if market values were lower than book values, then the adjustment would reduce the market-based cost of equity. As discussed in the Utilities' Initial Brief, Staff's arguments that the Commission should ignore the difference in the financial risk between market value and book value capitalizations of the proxy group are wrong and speculative. NS-PGL Init. Brief 71-72. Also, Mr. Thomas' argument that utilities with market-to-book ratios greater than 1.0 are already earning more than their cost of equity is unsupported and contrary to the regulation of utilities by this Commission and others for most of

[16] Mr. Moul also applied a similar adjustment to develop "leveraged" betas for use in the CAPM model. Moul Dir., PGL Ex. PRM-1.0 REV, 37:823-38:840; Moul Dir., NS Ex. PRM-1.0 REV, 37:801 – 38:818.

the past 50 years. *Id.* at 72-73. Ms. Kight-Garlisch contradicts herself by arguing that Mr. Thomas' "premise is oversimplified. There are many utility ratemaking practices (e.g., deferred taxes and depreciation) that could result in a utility's market value exceeding its book value." Kight-Garlisch Reb., Staff Ex. 18.0, 19:377-379. This is contrary to her argument against the Mr. Moul's financial leverage adjustment that a market-to-book ratio greater than 1.0 can mean only one of two things, "(1) the investor-required rate of return has fallen or (2) expectations of future earnings have risen." Kight-Garlisch Dir., Staff Ex. 6.0, 33:626-627.

If the difference in financial risk between market value and book value capitalizations of the proxy group is ignored, then that is another reason to reject Staff's "financial risk" adjustment to the financial model results. Staff cannot insist on an adjustment that seeks to bring the Utilities' cost of equity into line with their financial risk as reflected by their credit ratings, while at the same time ignoring another adjustment that seeks to bring the proxy group's cost of equity into line with its financial risk as reflected by its book value capitalization. Staff cannot have it both ways.

<u>Staff's Inconsistent Treatment of Mr. Moul's Proxy Group</u>

In addition to its inconsistent consideration of financial risk in the financial model costs equity as applied to the proxy group's book value capitalizations, Staff's "financial risk" adjustment is based on an inconsistent treatment of Mr. Moul's utility sample as an appropriate proxy for the Utilities in the application of the financial models. On one hand, Staff accepted the sample of gas utility companies assembled by Mr. Moul as "reasonable operating risk proxies" for the Utilities in the DCF and CAPM market models. Staff Init. Br. at 52. Yet, after running the models and averaging their results, Ms. Kight-Garlisch reconsidered "the suitability of that cost of equity estimate for North Shore and Peoples Gas" by "assess[ing] the risk level of her Utility Sample relative to that of [the Utilities]." *Id.* at 54.

It does not work that way. When a utility's common stock is not publicly traded – as here because the utilities are subsidiaries of a holding company – the analyst must assemble a proxy group of publicly-traded utilities with comparable risk and use their financial data as inputs to the models. The compilation of a proxy group involves the consideration both operational risk and financial risk. Mr. Moul evaluated his utility sample for a wide variety of financial parameters, including credit ratings, and determined that the proxy group <u>on balance</u> had a sufficiently comparable level of operational and financial risk to the Utilities for purposes of the financial models. NS-PGL Init. Br. at 84. Staff's cost of equity witness (and CUB-City's) used Mr. Moul's utility sample to run the financial models.

But Staff adjusted its financial model results based on a comparison of financial risk between the proxy group and the Utilities based on credit rating parameters. By contrast, Mr. Moul's financial leverage adjustment is applied to every utility in the proxy group in order to recognize the risk differential between each utility's market and book value capitalization.

The fallacy of Staff's "financial risk" adjustment is that the risk associated with the utility sample differs from the Utilities' risk only with respect to credit ratings. To the contrary, as Mr. Moul testified, the proxy group's collective financial parameters differed from the Utilities' in one way or another, but <u>on balance</u> reflected comparable overall risk. Thus, to the extent that the utility sample reflected a different average credit rating than the Utilities, that difference was offset by differences in other financial parameters that indicate the Utilities have more risk than the proxy group. As Mr. Moul testified:

> The risk of Peoples Gas parallels that of the Gas Group. Peoples Gas has maintained somewhat higher common equity ratios, fixed

> charge coverages, and IGF to construction than the Gas Group. On the other hand, the Company's earnings variability has exceeded that of the Gas Group and its operating ratios were somewhat higher than the Gas Group. The Company has comparable earnings quality to the Gas Group. From these comparisons, some risk indicators are higher for the Company, some are lower, and others are about the same. On balance, the risk factors average out, indicating that the cost of equity for the Gas Group would provide a reasonable basis for measuring the Company's cost of equity.

Moul Dir., PGL Ex. PRM-1.0 REV, 14:288-296; *see also* Moul Dir., NS Ex. PRM-1.0 REV, 13:281-14:289.

Staff argues that the Commission "should not ignore the level of financial strength implied by the [S&P] benchmark ratios [for credit ratings] in comparing the riskiness of [the Utilities] versus the proxy sample." Staff Init. Br. at 61. The Utilities did no such thing. The level of financial strength implied by the proxy group's credit ratings were among Mr. Moul's many considerations in building the proxy group. It is Staff that ignores all of the other financial parameters that create the <u>balance</u> of risk on which the proxy group is based.

It was unfair and inappropriate for Staff to select credit rating for an adjustment to the market model results without a comprehensive comparison and adjustment for all of the other financial parameters on which the utility sample was based. Otherwise, the Commission must assume that any decreased risk associated with the Utilities' stand-alone credit ratings were offset by increased risk associated with other financial parameters.

Either the proxy group was comparable or it was not. Staff cannot have it both ways.

<u>CUB-City's Objection to the Use of Averages</u>

CUB-City mischaracterize Mr. Moul's testimony on the use of averaging by Ms. Kight-Garlisch, and then unfairly criticize Mr. Moul for averaging his financial model results. Fortunately, this is easily sorted out.

Mr. Moul did not criticize Ms. Kight-Garlisch for averaging her financial model results to obtain her 9.70% ROE recommendation for Peoples Gas and 9.50% for North Shore. The testimony quoted by CUB-City at page 39 of their Initial Brief relates to Ms. Kight-Garlisch's DCF and CAPM results for <u>one</u> of the gas utilities in the proxy group. Her DCF result for Nicor was 5.91%, which is lower than the utility cost of debt, while her CAPM result for Nicor was 14.82%, which is much higher than any reasonable investor could expect. Kight-Garlisch Reb., Staff Ex. 18.0, 8:154-157. She suggested that these results were nonetheless reasonable because they averaged out to 10.37%. *Id.* at 8:161-162. It was this averaging to which Mr. Moul referred when he testified that "missing the target by ten feet to the right on the first try, followed by a miss of ten feet on the second try, does not equal an average 'bull's eye.'" Moul Sur., NS-PGL Ex. PRM-3.0, 8:181-183.

Mr. Moul's criticism of Ms. Kight-Garlisch's averaging of her market model results is not that she averaged them, but that her methodology gives too much credence to the DCF model. In her averaging of only two financial models, the DCF result is weighted 50%. Mr. Moul ran four market models and averaged the results of the three of them (excluding the highest result from the average). Moul Dir., PGL Ex. PRM-1.0 REV, 3:59-4:72; Moul Dir., NS Ex. PRM-1.0 REV, 3:57 – 4:73. This reduced the weighting of the DCF result in Mr. Moul's result to 33%.

By contrast to both Ms. Kight-Garlisch and Mr. Moul, Mr. Thomas used his DCF result, the lower of his two financial model results, as his recommendation. CUB-City argue that it was unreasonable for Mr. Moul and Ms. Kight-Garlisch to average their results because they varied by 232 basis points and 311 basis points, respectively. CUB-City Init. Br. 39. CUB-City argue that the variation in results means there must be something fishy about them: "If each estimate is supposed to be a valid measure of objective market factors, then they cannot all be correct." *Id.*

That is precisely Mr. Moul's and Ms. Kight-Garlisch's point. They do not base their ROE recommendation on the result of a single model because none of them <u>are</u> "correct." "In general, the use of more than one model provides a superior foundation to arrive at the cost of equity. . . . [E]ach model relies on different assumptions, and each has its own limitations. In addition, at any point in time, reliance on a single model can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment." Moul Dir., PGL Ex. PRM-1.0 REV, 3:62-66; Moul Dir., NS Ex. PRM-1.0 REV, 3:63-37. "[N]o one model of the cost of equity can be applied in an isolated manner. . . . [E]ach of the models . . . contains certain incomplete and/or overly restrictive assumptions and constraints that are not optimal." *PGL id.* at 14:307-311; *NS id*. at 14:300-304. "A thorough analysis of the required rate of return on common equity requires both the application of financial models and the analyst's informed judgment. An estimate of the required rate of return on common equity based solely on judgment is inappropriate. Nevertheless, because techniques to measure the required rate of return on common equity necessarily employ proxies for investor expectations, judgment remains necessary to evaluate the results of such analyses." Kight-Garlisch Dir., Staff Ex. 6.0, 15:285-291.

Mr. Thomas and his ROE recommendation of 8.11% (below 8% if the decoupling riders are approved) are the outliers in this case.

<u>Do Lower Taxes and Government Security Interest Rates Mean that the Utilities' ROEs Must Be Set Lower Than They Were in 1995?</u>

CUB-City have developed a simple argument that, on its face, sounds reasonable. In the Utilities' last rate case, the Commission authorized ROEs of 11.10% for Peoples Gas and

11.30% for North Shore. Since then, income tax and interest rates on government securities have gone down. Therefore, claims Cub-City, the Utilities' cost of equity must have gone down. CUB-City Init. Br. at 25.

This might be an understandable argument coming from a layperson. It is not a reasonable argument coming from a party that sponsored an expert witness on cost of equity. CUB-City cannot with a straight face dispute that current tax and risk-free interest rates are already considered in the financial models utilized by its cost of equity witness and those of Staff and the Utilities. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 22:485 - 23:508. The derivation of costs of equity through the financial models involves numerous variables, of which income tax and risk-free interest rates are only two. To consider these two variables outside of the financial models would be to double count them. CUB-City's "overall market developments" argument is a sham. The Commission should approve an ROE of 11.06%.

D. Flotation Costs

The Utilities' request for recovery of flotation costs remain at issue. *See* NS-PGL Init. Br. at 93; Staff Init. Br. at 75-76; CUB-City Init. Br. at 48-50. The Utilities incorporate their Initial Brief (at 93).

E. Weighted Average Cost of Capital

1. Peoples Gas and 2. North Shore (Combined Discussion)

The Utilities' proposed weighted average costs of capital remain as stated in their Initial Brief (at 93-94).

V. HUB SERVICES

Staff argues that it was imprudent for Peoples Gas to offer Hub services. The evidence, however, amply demonstrates that the customer benefits provided by the Hub have exceeded and are expected to continue to exceed the costs of providing the service. Zack Reb., NS-PGL Ex. TZ-2.0, Zack Sur., NS-PGL Ex. TZ-3.0 Rev. Moreover, even if one were to accept Staff's asseetion regarding the prudence of Hub operations, Staff's adjustment goes way beyond what the law calls for.

Faced with this record, Staff has resorted to baseless assertions and re-airing their issues from ICC Docket No. 01-0707. Notwithstanding the assurance that the present matter before the Commission is clearly about "test year 2006" (Rearden, Tr. at 683), in no less than 15 different places in its brief, instead of arguing matters relevant to this test year, Staff harkens back to ICC Docket No. 01-0707. Since 2001, however, Enron is gone, ICC Docket No. 01-0707 has been resolved and a final order has been entered, Peoples Gas has established its compliance with the Commission's order, and now new investors have acquired Peoples Gas and North Shore. Staff seems not to have noticed, although Dr. Rearden admitted that there is no support in the record to suggest that Peoples Gas' storage operations are not perfectly legitimate. Rearden, Tr. at 683. The record demonstrates that the Hub, as operated under FERC and ICC orders, actually provides useful services for wholesale customers, operational benefits for the storage field, and a tidy $10 million-plus per year financial benefit for sales customers and transportation customers purchasing company gas.

A. Manlove Field and Its Base Gas Requirements

In order to show that offering Hub services was imprudent, Staff would need to demonstrate that the costs were higher than the benefits to customers. To make it appear that the Hub has caused huge amounts of extra cost, Staff needs to establish that huge amounts of base gas are needed to support the Hub. The essence of Staff's arguments on Manlove Field, therefore, is that Peoples Gas has understated its base gas injections used to support Hub services.

The argument fails, however, as the facts do not bear out Staff's claim. Peoples Gas has been injecting base gas to support Manlove Field's operation generally, including both storage for sales customers, services to its transportation customers, and FERC-jurisdictional Hub operations. Zack Reb., NS-PGL Ex. TZ 2.0, 68:1508-1512. Properly allocating the cost of the base gas supporting Hub operations, the Hub's revenues easily exceed costs. NS-PGL Ex. TZ - 2.07. With the cost of base gas being shared by Hub customers, and all the revenues credited to the sales customers through the Purchased Gas Adjustment, this is a very nice deal for the customers. Zack Reb., NS-PGL Ex. TZ 2.0, 68:1520-1524.

1. <u>Staff's Assumed "Historical Ratio"</u>

Because Staff is unable or unwilling to accept any figures on base gas from Peoples Gas, Staff has set out to do its own, completely hypothetical "calculation" of base gas requirements. Staff Init. Br. at 95. Staff's method is to look at the entire 40-year history of Manlove Field, and look at the ratio of working gas to base gas at a single point in time, 1997. Staff then applies this ratio to the incremental expansion of working gas to allow Hub services. D. Anderson Dir., Staff Ex. 10.0, 21:420-426. The result is a whopping 45.3 Bcf of base gas that Staff wants to attribute to operating the Hub. *Id.* at 21:426-22:429.

This calculation is meaningless. Staff's "historical ratio" was refuted by Mr. Puracchio, who has a great deal of history and experience with Manlove Field that Staff's witness, Mr. Anderson, does not. Compare Puracchio, Tr. 447:17-450:5 with D. Anderson, Tr. 467:9-469:1. As demonstrated by Mr. Puracchio, the base gas requirements for initially storing gas in an underground aquifer are much higher in earlier field development years than they are later on. Puracchio Reb., NS-PGL Ex. TLP-2.0, 8:157-168. This is demonstrated by NS-PGL Ex. TLP-2.6, which shows the percentage of injections that are base gas, year by year. The blue and green lines on the graph show that on a year to year basis Mr. Anderson's "historical ratio" of 22% has not held true since the 1970's. *Id.* To apply a straight "historical ratio" through 1997 to each subsequent year's incremental increases is inappropriate and doesn't account for the fact that the bulk of the cushion gas to support the incremental increases was already in place in 1997. Nor does it take into account the effect of increasing gas saturations and average reservoir pressures. NS-PGL Ex. TLP-2.7.

The fallacy of the "historical ratio" can be demonstrated using facts that Staff concedes. Mr. Anderson agrees that, even without growth of the working gas, some amount of base gas will be needed each year. D. Anderson Dir., Staff Ex. 10.0, 11:209-213. If that is true, in a field with constant working gas, the ratio of working gas to base gas will change every year, as working gas stays constant and base gas increases. There is no such thing as a constant "historical ratio" that can be used to predict future base gas requirements.

Over the 40 years Manlove has been in existence, Peoples Gas has injected a great deal of gas into the field as base gas. Again, as both Staff and Peoples Gas witnesses agree, gas slowly creeps outward over time, invading new areas. D. Anderson Dir., Staff Ex. 10.0, 24:470-473 (quoting Mr. Puracchio). When Peoples Gas began gradually increasing its working gas to enable Hub operations, it was primarily able to do so with the support of base gas already underground. Puracchio Reb., NS-PGL Ex. TLP-2.0, 8:169-9:188. To further support all storage operations, including both Hub and other storage, Peoples Gas has added base gas going forward at the rate of 3.5%, and this has proved adequate to keep the field operating properly. *Id.* at 7:156-158. Normal field performance is the main way to tell that the right amount of base gas has been injected. *Id.* at 8:169-9:188; *see also* D. Anderson, Tr. 485:14 - 486:6. Staff's hypothetical "historical ratio" calculation has nothing to do with field operations, actual testing or experience, or anything else that counts. The calculation is unnecessary and incorrect. Staff's conclusion from it, that "within a few years" Peoples Gas will need to inject an additional 37.4 Bcf, is unsupported by the evidence.

It is difficult to reconcile Staff's testimony and argument on this issue with the objective facts in the record. This is not a simple difference of opinion between storage experts presenting legitimate arguments over a small discrepancy. Despite all the evidence, Staff continues to argue about whether or not there is or will be a need to inject an additional 37.4 Bcf of cushion gas – truly a huge amount of gas. Staff simply failed to conduct a reasoned analysis of the arguments and actual performance data presented by Peoples Gas.

2. <u>Peoples Gas' Proper Injection of Base Gas</u>

Staff and Peoples Gas actually do agree on something in this area. Staff concedes that it was *not* improper to inject no base gas on day one of Hub operations, but rather, as Peoples Gas did, to continually inject a certain amount of gas each year to support overall operations. Staff Init. Br. at 97.

Peoples Gas' procedure particularly makes sense given the actual development of the Hub, and the working gas required to support it. Staff makes it seem as if, one day in 1998, Peoples Gas opened up 8 Bcf of new working gas for Hub operations, and later expanded it to 10 Bcf. Staff Init. Br. at 95. That is not the case. Zack Reb., NS-PGL Ex. TZ-2.0, 66:1482-67:1485. For this reason, the table on page 95 of Staff's Initial Brief is quite wrong, as it implies a 30% increase in working gas in a single year, when the real figure is about 6.5%. Ex. TLP-2.8 tells the real story. Column (a) of that table shows the growth of the Hub inventory over time.

In 1998, Hub inventory was just 1.5 Bcf, and did not go above 8 Bcf for several more years, in 2002. *Id.* The idea that Peoples Gas should have injected over 45 Bcf of base gas to support these volumes is not right. NS-PGL Ex. TLP-2.8 also shows, in column (d), the total amount of base gas ("cushion gas" in the exhibit) injected by Peoples Gas, and in column (e), the amount of base gas appropriately attributed to the Hub. Staff says it has asked and asked for this number, but Staff has it: Peoples Gas has injected 1.34 Bcf of base gas to support Hub operations. *Id.*

Doc. No. 07-0241
and No. 07-0242
Consol.

Exhibit TLP-2.8

Estimation of Cushion Gas Associated with Hub Operations

Fiscal Year	(a) Hub Storage Capacity (dth)	(b) Total Working Gas Capacity (dth)	(c) = (a/b) Ratio of Hub Capacity To Total Working Gas	(d) Cushion Gas Capitalized (dth)	(e) = (c x d) **Cushion Gas Associated with Hub Capacity (dth)**
1997	0	26,300,000	-	1,500,000	-
1998	1,700,000	28,000,000	0.061	1,500,000	91,500
1999	5,700,000	32,000,000	0.178	-	-
2000	7,300,000	33,600,000	0.217	-	-
2001	7,300,000	33,600,000	0.217	742,900	161,209
2002	8,300,000	34,600,000	0.240	707,050	169,692
2003	8,300,000	34,600,000	0.240	736,470	176,753
2004	9,600,000	35,900,000	0.267	760,166	202,964
2005	10,200,000	36,500,000	0.279	736,666	205,530
2006	10,200,000	36,500,000	0.279	1,197,247	334,032
				7,880,499	**1,341,680**

Although Staff "does not disagree" that Peoples Gas can operate Manlove Field by continuous injection of base gas, Staff has two concerns, neither of which proves valid. First, Staff worries that the continuous injection provides a "subsidy" to the Hub, because it is supported by "ratepayers' gas." Staff Init. Br. at 97. Second, Staff worries that the cost of the base gas injections will vary over time as the price of gas changes. However, neither of the problems is real, due to the solution that the Commission has already put into place. In its Final Order in the 2001 Gas Reconciliation Docket, the Commission ordered Peoples Gas to do two things in this area. First, the cost of base gas injected for the benefit of North Shore and other third parties is to be borne by those parties. *Illinois Commerce Comm'n v. Peoples Gas Light & Coke Co.*, ICC Dkt. No. 01-0707 (Order March 28, 2006) ("*Peoples Gas 2001 Reconciliation*"), p. 9, para. (11). Second, as has been discussed at length, although the services themselves may be regulated by the FERC, Peoples Gas' customers get all the Hub revenues through the Gas Charge. *Id.* at 8. This completely takes care of Staff's concerns: there is no "subsidy" if FERC-jurisdictional customers get their fair share of the costs, and, in any event, the money generated goes to customers (not the Hub customers and not Peoples Gas' shareholders) anyway. Zack Reb., NS-PGL Ex. TZ-2.0, 66:1474-1481. If anything, this is Hub customers subsidizing sales customers. *Id.* at 68:1516-1524.

Peoples Gas discussed in its Initial Brief (at 97, footnote 17) the apparent increase from 2.0% base gas injections to 3.5%, an increase that looks much bigger than it is. Peoples Gas only mentions it again here because Staff seems not to have understood this point. *E.g.*, Staff Init. Br. at 104-105. Due to a metering inaccuracy, when the meters indicated a 2% injection, the real amount was between 3.0% and 3.5%. PGL Ex. TLP 2.5. After the meters were fixed, Peoples Gas began injecting a real 2.0% for a time, and quickly saw field performance fall off. Once injections were raised again to 3.5%, field performance rebounded, and Peoples Gas has continued 3.5% injections since. Puracchio Reb., NS-PGL Ex. TLP-2.0, 7:136-8:168. The point of this discussion is that Peoples Gas did not under-inject base gas for years, and then nearly double its injections to catch up. If Staff drew this inference, it is erroneous.

Another point can be drawn from the 2.0% and 3.5% metering issue. During the period after the meters were fixed and Peoples Gas was only injecting a real 2.0%, the shortfall – the difference between 2.0% and 3.5% base gas injections – was only 0.6 Bcf per year. Puracchio Reb., NS-PGL Ex. TLP-2.0, 9:194-198. Yet, in just two years' time with this small shortfall, field performance fell off noticeably. *Id.* at 5:93-102. This demonstrates that Staff's contention that Peoples Gas has under-injected base gas by 37.4 Bcf – over 60 times 0.6 – is without merit. A shortfall that large would have been noticed long ago; instead, the correct conclusion is that Peoples Gas' capitalized injections of 7.88 Bcf have been the right amount to keep the field operating properly.

3. Compliance with the Commission's Order in the *Peoples Gas 2001 Reconciliation* Docket

Staff makes a serious and unwarranted accusation that Peoples Gas has not complied with a Commission order. The charges turn out to be untrue, in two different ways.

First, Peoples Gas has complied with the maintenance gas provisions of the Final Order in *Peoples Gas 2001 Reconciliation*, ICC DocketNo. 01-0707, completely. As discussed above, Peoples Gas calculates its Hub rates to include the cost of base gas, so that Hub customers bear that cost. Zack Reb., NS-PGL Ex. TZ-2.0, 66:1474-1481. Peoples Gas made a compliance filing with the Commission to change the maintenance accounting to capitalize maintenance gas costs and cease recovery as gas lost and unaccounted for, so the statement that "Staff's review has found no indication that Peoples Gas made any attempt to comply with this requirement" (Staff Init. Br. at 109) is myopic at best. Staff's mock surprise that Mr. Puracchio was unaware of Peoples Gas' compliance efforts should be discounted. The order required Peoples Gas to "revise its maintenance gas accounting procedures." *Peoples Gas 2001 Reconciliation,* final Order at p. 9. Staff should not be surprised that Mr. Puracchio, the operations manager at Manlove Field, was unaware of the precise accounting treatment of base gas, and the fact that at the hearing he did not know the answer to a question that should have been directed to another witness is not a legitimate concern. Puracchio, Tr. at 450:8-451:5, 453:20-454:4, 458:22-459:9 (referring such questions to Mr. Zack).

Second, Staff implies that the Commission ordered Peoples Gas to conduct a base gas study (Staff Init. Br. at 110), which the Commission did not. Perhaps as a discovery item, or as a suggestion to the Commission, Staff may have sought to have Peoples Gas to perform such a study. But the final Order did not contain such a requirement. Thus, Staff's claim that "Peoples Gas failed to conduct such studies . . . even though such studies were specifically requested in Docket No. 01-0707" should not be read as a statement that Peoples Gas violated a Commission order. In any event, a study at this time would be pointless as the evidence already demonstrates that a sufficient amount of cushion gas has been injected.

B. Peoples Gas' Justification for Providing Hub Services

Staff places an inordinate amount of importance on the fact that neither Mr. Zack or Mr. Puracchio could identify the individual or group that was responsible for the decision to begin Hub services back in the 1990s, and suggests that Peoples Gas "is so embarrassed about its decision that no one will own up to it." Staff Init. Br. at 79-80. This is not a proper test as to whether assets were prudently acquired; Peoples Gas does not need to provide testimony of every original decision maker as to each asset in its rate base. The real question here is whether it is used and useful.

Neither Mr. Zack nor Mr. Puracchio were part of the decisions to begin offering this collection of services. Zack, Tr. at 531:14-532:5; Puracchio, Tr. at 454:5-455:1. So, not only did the Staff ask *only* these two people, but the two people they asked were not in the respective positions when the decisions were made. It's no wonder they do not know. Mr. Puracchio and Mr. Zack both testified – without apparent embarrassment – that during their tenure, the Hub has been operating as a benefit to the ratepayers. Zack Reb. NS-PGL Ex. TZ-2.0, 66:1469-1473. The Hub operation in fiscal 2006 (test year) brought $10 million in revenues (all credited to the Gas Charge) against an annual revenue requirement of $3.3 million. Zack Reb., NS-PGL Ex. TZ-2.0, 71:1573-1577. That is neither imprudent nor embarrassing.

C. <u>Peoples Gas' Allocation of Manlove Field's Peak Day Capacity</u>

Staff now argues, among other things, that Peoples Gas allocates peak day capacity for Hub customers, and in so doing affects rates charged customers (presumably negatively). Again, Staff launches a desperate argument in its crusade to impute imprudence to Peoples Gas' decisions. As Peoples Gas' witness Mr. Zack has made abundantly clear throughout his testimony and as stated in response to the data request cited by Mr. Anderson on the record (ENG 2.13), third parties had a small amount of peak day deliverability and will not have those rights after the order in this case. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1529-1531.

A more egregious example is presented when Staff attempts to argue that "when Peoples Gas misallocates capacity, then gas costs increase when Hub deliveries are enabled through expensive spot market purchases that (are) assigned to sales and transportation customers." Staff Init. Br. at 89. Staff is making reference to events that may or may not have occurred during fiscal year 2001. When Dr. Rearden was asked on cross examination whether he was aware of any such incidents as it relates to test year 2006, his response was "no." Rearden, Tr. at 682.

D. Staff's Prudence "Tests" of Peoples Gas' Decisions

Staff suggests that their witnesses "tested" the decision to start offering Hub services in 1998, the decision whether or not to keep providing Hub service, and have determined that in both instances the outcome was uneconomic. Staff Init. Br. at 94. Staff's analysis and "tests" are illusory, speculative, fraught with errors, and unsupported by the evidence in the record.

Staff's first test is to compare estimated incremental costs with expected Hub revenues. To make this test support their argument, Staff must "estimate" to the point where they can find enough costs to exceed revenues. For example, Staff argues that to expand Manlove Field's working gas by 8 Bcf, it believes that Peoples Gas must ultimately inject an additional 36 Bcf of base gas. Peoples Gas witness Mr. Zack not only disagrees with this analysis, see NS-PGL Ex. TZ-2.07, but also shows where Dr. Rearden's mathematical errors led to an "over estimate" of base gas. Zack Sur., NS-PGL Ex. TZ-3.0, 41:917-43:941, and NS-PGL Ex. TZ-3.7.

Staff's argument depends on estimates that are not supported by the record and are not based on reliable evidence of experts who possess a working knowledge of Manlove Field. D. Anderson, Tr. at 469:9-10. Staff's arguments are so one-sided and subjective that they are of no probative value. For example, when comparing revenues to costs of Manlove Field to determine benefit to ratepayers, Staff raises the argument that both Mr. Zack and its own witness, Dr. Rearden, overestimate the Manlove Field expansion benefits. Staff goes on to say that they both assume the entire amount of "Hub revenues depend on Manlove Field's expansion." The Staff asserts that of the $10 million of revenues that are directed to the PGA that the real benefit is only $8.8 million because $1.2 million is actually derived from transportation services that could exist without the Hub expansion. In reality, the facts show that the $10 million actually offsets gas cost through the PGA. Therefore, the full $10 million contribution to the PGA is still a benefit to the ratepayers. Also, of course, even the $8.8 million is still over 2½ times the Hub revenue requirement of $3.3 million. NS-PGL Ex. TZ-2.7.

Most importantly, the analysis performed by Peoples Gas and accepted by Staff witness Rearden using his own definition, shows that the operation of the Hub is a benefit to Peoples Gas' customers. Rearden, Tr. at 674:1-4. Moreover, it will continue to be a benefit in the future. Zack Sur. NS-PGL Ex. TZ-3.0 REV, 41:917-42:933.

E. Staff's Argument Regarding Lack of Commission Approval to Expand Manlove Field

Staff, it must be said, has never been a fan of the Peoples Gas Hub. On behalf of the Commission, Staff intervened in the proceeding at FERC in which Peoples Gas received permission to offer these services, *The Peoples Gas Light and Coke Co.*, CP98-84-000, final order reported at 82 FERC ¶62,145 (1998). Staff made extensive arguments in ICC Docket No. 01-0707 as to the shortcomings they perceived with the Hub. *Peoples Gas 2001 Reconciliation*, ICC Docket No. 01-0707, pp. 84-87 (Order March 28, 2006). And, Staff has been in other rate case proceedings in which the Nicor Gas Hub was a focus. *E.g.*, *In re Northern Illinois Gas Co.*, ICC Docket No. 95-0219; *In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779. Now, however, in 2007, Staff argues for the first time ever that Peoples Gas should have obtained approval, under Section 7-102(A)(g) of the Public Utilities Act, before even beginning to provide Hub services in 1998. Given Staff's strong feelings about Hub services, one would think that Staff might have raised this argument sometime during the last ten years if they really thought the Hub should have received the Commission's pre-approval.

1. Application of Section 7-102(A)(g)

It turns out, of course, that Section 7-102(A)(g) does not apply here. Section 7-102(A)(g) reads in pertinent part:

> (A) Unless the consent and approval of the Commission is first obtained or unless such approval is waived by the Commission or is exempted in accordance with the provisions of this Section or of any other Section of this Act:
>
> ….
>
> (g) No public utility may use, appropriate, or divert any of its moneys, property or other resources in or to any business or enterprise which is not, prior to such use, appropriation or diversion essentially and directly connected with or a proper and necessary department or division of the business of such public utility; provided that this subsection shall not be construed as modifying subsections (a) through (e) of this Section.

220 ILCS 5/7-102(A)(g). Under Section 7-102(A)(g), a public utility must obtain approval from the Commission before it may employ its public utility resources in "any business or enterprise" that is not "essentially and directly connected with or a proper department of division of the utility business." Section 7-102(A) (g) would only be applicable to Hub services if they were unconnected to distribution, storage and sale of gas i.e., "the business of such public utility". That is obviously not the case.

Staff refers to "the Hub" as if it is a building, or a division or separate enterprise, but it is not. The Hub is Peoples Gas. Zack Reb., NS-PGL Ex. TZ-2.0, 70:1547-1549. Hub services are the same public utility services – storage and transportation of natural gas – as the rest of the integrated utility. These particular services are regulated by the FERC, and have rates approved by that other utility regulator, but they are utility services. Peoples Gas has not diverted property to a business or enterprise that is not essentially and directly connected to its public utility business. Peoples Gas has not diverted property to a business or enterprise that is not a proper and necessary division of its public utility business. Accordingly, Section 7-102 approval is not necessary.

Peoples Gas began offering Hub service as a means to more efficiently utilize the existing Manlove and Mahomet pipeline assets and to provide customer benefits. Since Peoples Gas began offering these services, all of its expenses, including and consisting of over $7 million of incremental compressor fuel costs have been borne by Peoples Gas. None of the costs were paid by Peoples Gas' customers. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1538-1546. Moreover, any revenues that it receives only serve to lower the cost of gas for all customers. So, Hub services provide ratepayer benefits in three ways: (1) through credits to the Gas Charge;[17] (2) by extending the Manlove decline point, and (3) by increasing market liquidity at the Chicago City gate, which in turn, creates downward pressure on gas prices. All or any of these benefits are clearly "connected with or a proper department or division of the business of such public utility". Section 7-102(A)(g). If Hub services were not part of the utility business, it seems unlikely that the Commission would have ordered revenues to go to utility customers through the Gas Charge, but that is what the Commission did in the *Peoples Gas 2001 Reconciliation* docket.

Staff's argument that the purpose of the Hub is to "appropriate or divert [the utility's] moneys, property other resources," is meritless. Because the Hub is completely within Peoples Gas, nothing is diverted. Staff cites a discussion between Administrative Law Judge Moran and Mr. Puracchio wherein Mr. Puracchio was confirming Judge Moran's understanding that the Hub "takes advantage of excess capacity in the system." Puracchio, Tr. at 458:12-15. Staff turns this discussion on its head, saying that it demonstrates Hub services are not "essentially and directly connected with or a proper department or division" of the utility's business. In reality, what the discussion demonstrates is just the opposite. The Hub uses excess capacity of the utility, proving that it is indeed part of the total system, particularly, where as here, all benefits flow to the ratepayers.

[17] When the Hub first began operations and prior to the time Peoples Gas began to flow revenues through the Gas Charge, Hub revenues were accounted for above the line and would have inured to the benefit of ratepayers in Peoples Gas' next rate case. This was consistent with the approach that the Commission had required for Nicor Gas. *In re Northern Illinois Gas Company*, ICC Docket No. 93-0320, 1996 Ill PUC LEXIS 151 at *11 (Order March 13, 1996).

Staff suggests that Peoples Gas' testimony discussing how Peoples Gas might phase out its Hub services, if the Commission ordered it, proves that the Hub is not essential or a part of the utility business. Staff says "if the Hub was essential to utility business no such phase out would be possible." Peoples Gas' testimony about the need for a transition was simply pointing out the obvious fact that, if Peoples Gas no longer offers Hub services, it must determine how best to use the Hub capacity, including as additional storage capacity for ratepayers or to displace purchased services that support service to ratepayers. That is an essential part of the utility business. Zack Sur., NS-PGL Ex. TEZ-3.0, 43:945-950. In the instant case, Peoples Gas originally sought to phase out the Rider FST Tariff. Under Staff's logic, the ability to phase out Rider FST transportation service would mean that transportation programs were not "essential to the utility business", which does not comport with the facts.

Staff cites several cases that it contends support its argument that Peoples Gas' operation of the Hub requires approval from the Commission under Section 7-102(A)(g). These cases do nothing of the sort. First, virtually all the cases cited by Staff involve situations where the utility decided to file a 7-102 petition, so the issue of whether it was truly necessary was not before the Commission or the court. So, for example, in *Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 295 Ill. App. 3d 311 (1998) ("*ComEd*"), in which ComEd sought permission from the Commission to provide energy support services, the issue was solely whether Commission correctly denied the petition on its merits. In any event, there would have been little doubt that Section 7-102(A)(g) would apply in that case, since ComEd sought approval to engage in entirely different activities than its essential business of furnishing electricity. Most of the Commission cases cited by Staff are similar, and similarly do not support Staff's rationale.

Staff does cite a few cases involving the failure to obtain Section 7-102 approval, but the facts are so different that they do not help Staff's cause. *People v. Phelps*, 67 Ill. App. 3d 976 (5th Dist. 1978), involved a criminal prosecution against one who owned controlling interests in a water utility and its parent holding company. When the defendant caused the water company to borrow more than $1 million and transfer it to the parent company to support speculative, non-utility "investments," the defendant was charged with, among other things, failing to get Section 27(g) (predecessor to 7-102(A)(g) of the PUA) approval from the Commission. While Staff enjoys portraying Peoples Gas' Hub services as evil and nefarious, the differences in the cases are obvious. Here Peoples Gas is providing typical utility services like gas storage, to the financial benefit of customers purchasing gas from the utility.

Staff does cite one Commission decision finding that Section 7-102(A)(g) does apply to a particular situation, but again, the case is factually distinguishable from this case. In *MidAmerican Energy Co.*, ICC Docket No. 03-0659, the Commission issued a declaratory ruling the approvals MidAmerican would need before it could legally sell gas as a competitive supplier within its approved service territory. Section 7-102(A)(g) applied, because acting as a competitive supplier involved creating a competitive gas division, which was not an essential part of a public utility. The Commission had understandable concerns that utility assets could be funding operations that did not benefit customers. Here, the situation is different: Peoples Gas is providing regulated services (regulated by the FERC), and, pursuant to the Commission's own ruling, is providing the financial benefits to its customers. Whereas the cross-subsidization of a separate division of the utility was at issue in *MidAmerican*, it is not here.

Finally, Staff cites *Peoria Chapter, National Electrical Contractors Association, Inc. v. Illinois Commerce Comm'n*, 37 Ill. 2d 55 (1967)("*Peoria*"), though it is not clear why, as the case favors Peoples Gas' position. In *Peoria*, the question was whether an electric utility should have obtained advance approval under Section 27(g) before signing a contract to power street lights. The court held that advance approval was not required explaining that "street lighting maintenance services are a part of one of the oldest services rendered by [CILCO] as an electric public utility". Peoples Gas has operated Manlove Field since 1964, and simply accommodates the transportation and storage of gas for customers, clearly within the activity of the utility.

As mentioned above, Staff cites a number of Commission decisions on petitions filed under Section 7-102(A)(g), which, of course, do nothing to determine whether particular actions are actually covered by the section. Staff cannot invent precedent by showing that this utility or that decided to petition the Commission. Staff has even gotten clever in its description of *Commonwealth Edison Co.*, ICC Docket No. 96-0175, 1996 Ill. PUC LEXIS 325 (Order June 26, 1996). ComEd sought to obtain Commission approval to lease out storage space in fuel tanks at one of its power plants. Staff describes the operation as a "hub of sorts," in an attempt to make an irrelevant case appear germane. The analogy quickly breaks down, however: ComEd is an electric utility, and running an oil storage operation is not an essential part of its business. The services that Peoples Gas provides at Manlove Field are part of its essential business of storing and transporting natural gas.

Clearly, Section 7-102(A)(g) is not applicable to the facts at hand and, therefore, Peoples Gas is not required by Section 7-102(A)(g) to seek prior approval from the Commission pertaining to the expansion of Manlove Field.

2. <u>The Commission Has Already Ruled on Hub Services</u>

One case that Staff did not cite is *McMillin v. Economic Laboratories, Inc.*, 127 Ill. App. 3d 517 (3d Dist. 1984). A landowner, the plaintiff in a trespass case, had obtained his property from a railroad. The defendant argued that the property sale was void because there had been no Commission approval under the predecessor to Section 7-102(A). The court held that the sale was not void despite the lack of approval, because the Commission had issued an order directing the railroad as to disposal of the property. *McMillin*, 127 Ill. App. 3d at 522. In this case, the fact that Peoples Gas is providing the services at issue is not a surprise to the Commission, as it was in *MidAmerican.* Hub services have already been the subject of proceedings at the Commission, and the Commission has issued specific orders to Peoples Gas as to how to account for those services and who gets the revenues. *Illinois Commerce Comm'n v. Peoples Gas*, ICC Docket No. 01-0707, pp. 8-9 (Order March 28, 2006). It is therefore past the time when Peoples Gas needs to go back and seek permission *ab initio.*

F. Staff's Proposed Disallowance

Staff contends that Peoples Gas has failed to prove that its costs of operating the Hub are just and reasonable and that those costs should therefore be removed from Peoples Gas' rate base. As shown above, the Hub is a net benefit to the utilities' customers. Its costs are prudently incurred and are used and useful in serving customers. While Peoples Gas has shown that the Hub is prudent, should the Commission agree with Staff, Staff's proposed disallowance of all base gas costs does not comport with the law.

First, there is something illogical about Staff's proposed disallowance. The premise of Staff's entire argument is that Peoples Gas *has not injected enough base gas*. Staff's proposed disallowance is to not let Peoples Gas put *any* base gas into rate base. That is clearly not correct.

Second, in its brief, Staff clearly states that they believe the incremental cost of the Hub is $13.3 million.Staff Init. Br. at 85. In the next paragraph, Staff provides an estimate of the Hub revenues of $10-$12 million. *Even accepting staff's position*, (which the Company does not), the incremental impact of the Hub is only $1.3 ($13.3-$12) to $3.3 million ($13.3-$10). When imprudence is found, only its incremental impact, if any, is disallowed. *E.g.*, *In re Central Ill. Light Co.,* ICC Docket No. 94-0040, 1994 Ill. PUC Lexis 577, **38-42 (Order Dec. 12, 1994). Therefore, even if the Commission finds imprudency, the disallowance should only be $1.3 million to $3.3 million disallowance, not the $34,857,000 of rate base (Staff Ex 24.0) plus the $2,533,000 of operations and maintenance expense (Staff Ex. 24.0).

G. Hub Procedures (Manlove Capacity Standards)

Staff witness Lounsberry proposed that Peoples Gas develop procedures to document how Peoples Gas allocates Manlove storage capacity and how it ensures that ratepayers are not harmed by its allocation decisions. Lounsberry Reb., Staff Ex. 23.0, 14:266-276. He recommended that Peoples Gas provide this information to the Director of the Energy Division within 60 days of the Commission's final order in this proceeding. *Id.* at 271-273 Peoples Gas' witness Mr. Zack testified that Peoples Gas would be willing to develop and document these procedures as proposed by Mr. Lounsberry, but that Peoples Gas proposed to provide this information to the Director of the Energy Division within 120 days of the Commission's final order in this proceeding given the number of rate case and other regulatory related matters to be addressed after the issuance of a final order. Zack Sur., NS-PGL Ex. TEZ-3.0, 43:945-948-839.

Staff, in its Initial Brief, agreed to the change to 120 days. Staff Init. Br. at 123. This matter is no longer contested.

VI. WEATHER NORMALIZATION – AVERAGING PERIOD

A. The Importance of Getting Weather Normalization Right

The Utilities have proposed, through Rider VBA or Rider WNA, to in effect remove the weather component from the Utilities' revenues. All parties have argued against those proposals, however. If the Commission does not approve one of these riders, the Utilities revenues will, as they do now, depend in significant part on what the average temperature happens to be for the next several winter heating seasons, until the next rate case. The rates set here will include a number of heating degree days (HDD) as one of the billing determinants. The closer that HDD number is to the actual HDD over the next few years, the closer the revenues approved here will be to those the Commission intends.

In their Initial Briefs, GCI ignores this, belittling the Utilities' attempts to "predict" or "forecast" future weather. The Utilities are not attempting to predict or forecast future winters' weather in the way a meteorologist predicts or forecasts tomorrow's weather using barometers, wind speeds, and radar. Takle Reb., NS-PGL Ex. EST-2.0, 3:60-4:78. For future years, the Utilities use averages of past years' HDD totals. Marozas Dir., PGL Ex. BMM-1.0, 2:45-3:55; Marozas Dir., NS Ex. BMM-1.0, 2:45-3:55. The GCI claim that an average of thirty years, from 1971 through 2000, constitutes a "long term average," and that should be used even if, statistically, it has been shown not to reflect current conditions. Glahn, Tr. At 1239:10-1240:16. That would be a mistake. The Commission should adopt the Utilities' proposed average of the most recent ten years, which, year in and year out, comes closer to "predicting" the HDD of the following year, the year after that, and indeed each year through at least year five. Marozas Sur., NS-PGL Ex. BMM-3.0, 2:37-3:46. That statistic, 6,044 HDD, is the proper normal weather on which to base the Utilities' rates. Marozas Dir., PGL Ex. BMM-1.0, 7:124-134, Marozas Dir., NS Ex. BMM-1.0, 7:124-134.

B. <u>GCI's Flawed Arguments</u>

The GCI's arguments against the 10-year normalization periods, contained in the separate briefs of City-CUB and the AG, take some unusual twists and turns. One cannot help but notice the paucity of argument *in favor* of the 30-year period that the GCI supposedly favor. This is because the record contains nothing – no study, no data, no expert support – nothing that suggests it will better reflect the climate over the next few years. Indeed, GCI essentially admit that they favor the 30-year average even though it will not reflect the next few years. Glahn, Tr. at 1239:6-19. All the data and studies that were done and admitted into evidence show a "clustering" of optimal climate normals in the 8-12 year range. Marozas Sur., NS-PGL Ex. BMM-3.0, 4:58-65. That the Utilities selected the center of that cluster, the same number selected for the utility next door, and recently approved by this Commission, is not arbitrary or unreasonable.

This is particularly true when one examines the root mean squared errors (RMSE), the statistic Mr. Marozas used to measure the predictive power of an averaging period. City-CUB inexpertly notes that the 10-year average was "only the fourth or fifth most accurate." The ordinal ranking is not the statistic of importance, however; the RMSE is. All of the cluster of best averaging periods (8, 12, 11, and 10) had RMSEs within 2% of each other. In other words, using the 10-year average only introduces a small amount of error compared to the 8-year average. By comparison, the NOAA 30-year average (which ranked near the bottom) had an RMSE 13% higher than the lowest error.

C. <u>The Superiority of Ten Years Over Thirty Years</u>

GCI excoriate the Utilities for choosing a "round" number like 10 years. City-CUB Init. Br. at 62; AG Init. Br. at 32. But using a round number, one that has been approved for other utilities, has the effect of rebutting, not demonstrating, that the Utilities are gaming the numbers. It is certainly not the Utilities who picked the best possible outcome, and then picked the normalization period that matched it. Indeed, one can only imagine what GCI's arguments would be if the Utilities had proposed an unusual eight-year climate normal (statistically the most accurate normal, but which also had among the very lowest HDD averages, and therefore would have favored the Utilities). Marozas Sur. NS-PGL Ex. BMM 3.0, 4:61-63; Tr. at 881:17- 20. Had the Utilities proposed an eight-year averaging period, they would have been accused of statistical dishonesty. Rather, it is the GCI who should face that question: there is nothing to recommend the NOAA 30-year normal in this proceeding other than the fact that it would cause the Utilities to realize much less revenue.

Similarly, GCI's focus on the extremely cold winter of 1996 is instructive. They seem to want 1996 included, but why? By their own admission, 1996 was an extreme outlier. City-Cub Init. Br. at 62; AG Init. Br. at 21. That should make it a poor addition when attempting to compute normal weather statistically. Cf. City-CUB Init. Br. at 61 (importance of avoiding "the distorting influence of an anomalous data point"). Again, the apparent reason is that it would increase the HDD average and artificially push down rates. It is GCI who are attempting to game the statistics for a particular result.

The selection of a thirty-year climate normal, either the most recent 30 years, or the 30 years from 1971-2000, as GCI's witness suggests, would be contrary to the evidence. On page 66 of their initial brief, City-CUB have a little chart showing the averaging periods that most accurately reflect future weather in the following year. The top candidates are all in the 8-12 cluster. City-CUB conveniently leave off their chart the rank of *their* proposed climate normal. That is no doubt because the 30-year normal is one of the least accurate predictors tested, both according to the Utilities' statistician, and the state's climatologists. Marozas Sur., NS-PGL Ex. BMM-3.0, 4:57-5:72 and Chart 1; Takle Reb., NS-PGL Ex. EST-2.0, 6:112-115.

The AG spends quite a bit of its Initial Brief focusing on Mr. Marozas' statistical test that compared the accuracy of different averaging periods to predict "one year ahead." AG Init. Br. at 20-23. The AG considers that a significant flaw in the study. The record convincingly demonstrates the opposite. The AG conveniently ignores the fact that Mr. Marozas also ran similar studies to check the accuracy of using ten years of data, or thirty years of data, to predict HDD two years into the future, as well as years three, four, and five. Marozas Sur., NS-PGL Ex. BMM-3.0, 2:30-3:46 and Table 1. In each of these tests, the ten year average was closer to the future year's HDD, and had less statistical error, than the thirty year average. *Id.*

D. <u>CUB-City's Misstatement Regarding 2007 Weather</u>

At page 62 of their Initial Brief, starting in the middle paragraph and continuing down the page, City-CUB have made a serious misstatement of the record, perhaps inadvertently, which the Utilities point out so the Commission is not misled by it. City-CUB flat out state that 2007 "like 1996, had very cold weather." The record, of course, does not contain any evidence as to the overall HDD for 2007 – the year not even being over yet. The record only says that there was a particularly cold snap during two weeks of 2007. AG Borgard Cross Ex. 4. Cold snaps can and do still happen, even in an otherwise warming climate. Takle, Tr. at 850:2-7. But what counts for weather normalization is not spikes, but total HDD for the year, which helps predict total gas sendout for the year. Grace Reb., NS-PGL Ex. VG-2.0, 25:524-539. For City-CUB to state as fact the incorrect inference that this past winter was a cold one – it wasn't – and to make the false statement that the Utilities' ten-year averaging period is "bracketed" like "bookends" by two extremely cold winters is irresponsible fiction. In truth, the middle and final paragraphs on page 62 of the City-CUB Initial Brief should be stricken by the judges or withdrawn by the parties that mistakenly filed it. Rather than file a motion, the Utilities will trust that the Commission will see through it.

To be clear, both 1996 and February 2007 stand for the proposition that a cold year or a cold month can happen, and no doubt will happen again. Takle, Tr. at 849:17-850:13. But it would not be normal.

E. <u>Looking Five Years Ahead Is Not Actually Necessary</u>

It is a real mischaracterization of the record for City-CUB to assert that five years is the length of time these rates will be in effect, and that the proper measure of the climate normal is predicting ahead five years. The City-CUB's repetition of this fable is tiresome. The Utilities expect the rates to be in effect for one to three years, and this is what Mr. Marozas assumed for his statistical analysis. Marozas, Tr. at 890:2-7. The mythical five year number comes from a settlement of the amortization schedule for rate case expenses. The Utilities had proposed a three year amortization schedule, consistent with the facts. Fiorella Dir., PGL Ex. SF-1.0, 23:496-505; Fiorella Dir., NS Ex. SF-1.0, 21:469 – 22:478. As a compromise, in order to narrow the contested issues, the Utilities agreed with other parties to a five-year amortization period. Fiorella Reb., NS-PGL Ex. SF-2.0, 6:115-127. This has the effect of lowering rates slightly, and the Utilities assumed that was the motivation for the suggested compromise. The Utilities had no idea that their compromise on a five year amortization would be used to argue that their climate normalization study should account for this assumed five year period of rates. In any event, Mr. Marozas demonstrated that a ten-year average is more accurate than a thirty-year average at predicting weather five years into the future. Marozas Sur., NS-PGL Ex. BMM-3.0, 2:37-3:46.

F. <u>Comparison of the Experts on Climate</u>

It is ironic that City-CUB and the AG would criticize the Utilities for their choice of expert witnesses and their particular assignments. They discount Mr. Marozas for having no climate expertise, and discount Professor Takle for not being a utility employee and regulatory expert. This is nonsense. The Utilities presented these two complementary witnesses, with different areas of expertise, precisely to avoid this sort of argument. Mr. Marozas is quite good at statistical analysis, as the record amply shows. He convincingly demonstrated the statistical superiority of the ten-year average over the thirty year average. Marozas Dir., PGL Ex. BMM-1.0, 4:69-7:134; Marozas Dir., NS Ex. BMM-1.0, 4:69-7:134. But he is not a climate expert. The Utilities therefore asked Professor Takle, a climate scientist, to review Mr. Marozas' work, to insure that the statistics agreed with the science. Professor Takle's testimony, therefore, showed that the results of Mr. Marozas' number-crunching are indeed reflected in the actual science: northern Illinois is trending warmer, consistent with the warming of the continental United States and the rest of the world. Takle Dir., PGL Ex. EST-1.0, 26:571-27:595; Takle Dir., NS Ex. EST-1.0, 26:570 – 27:594. Professor Takle used the sophisticated climate models, based on physics, not statistics, to estimate future HDDs in Northern Illinois, and found the results to be more consistent with the 10-year average than the 30-year average. *Id.*, PGL Ex. EST-1.0, 27:596-28:612; NS Ex. EST-1.0, 27:595 – 28:611. It therefore makes sense that an average that uses data from over thirty years ago would not properly reflect normal conditions over the next few years.

By contrast, the GCI's witness, Mr. Glahn, is a "management consultant" with no business talking about climate science and statistics. Takle Reb., NS-PGL Ex. EST-2.0, 2:31 - 3:47. He argued for a thirty-year average of 1971-2000, despite ample statistical and scientific evidence that it would not be representative of the next few years of weather. He did no analysis of his own, and found no mistakes in the Utilities' statistics.

G. **The Significance of the *Nicor Gas* Decision**

One reason the Utilities mentioned as an "ancillary benefit" of using a ten-year averaging period is that the Commission approved a ten-year period for Nicor Gas in its most recent rate case. Marozas, Tr. at 882:6-10. The GCI argue that this case is different from Nicor Gas' case.

The notion that the Utilities are using a "different ten year period than Nicor" (AG Init. Br. at 32) is misguided for two reasons. First, the methodology is precisely the same: each utility uses the average of the most recent 10 years. Nicor's case was filed in 2004, so naturally it has a different data set. (Plus, Nicor uses Midway data, not O'Hare.) Second, Nicor's approved ten-year HDD average was 5,830, significantly lower (warmer) than the Utilities proposed billing determinant here. *In re Northern Illinois Gas Co.*, ICC Dkt. No. 04-0779, Final Order at 53 (Sept. 20, 2005). Nicor's warmer average comes despite the fact that its ten-year average, 1994-2003, included the much ballyhooed 1996, the cold winter that GCI wished were included here.

The AG is correct, of course, that each case should be decided on its own factual record. AG Init. Br. at 27. The fact that the Commission approved the use of a 10-year average in the *Nicor Gas* case is not dispositive here. But the *Nicor Gas* decision does stand for the proposition that a 30-year average is not required, and that a utility can suggest, and the Commission can approve, a different averaging period if supported by the facts. *In re Northern Illinois Gas Co.*, ICC Docket. No. 04-0779, pp. 56-57 (Order Sept. 20, 2005). The evidence here is similar to that presented in Nicor Gas: a statistical analysis, backed up by a scientific opinion, demonstrate that the 10-year average will be much closer to normal for the next few years than will a 30-year average. And, contrary to what the GCI claim, the "opposition" to the utility's proposal is quite similar. GCI have not done their own study, and their conclusion that the Commission should use a 30-year period does not have any factual basis. Their support for the 30-year normal is not statistical or scientific, but based on tradition. Glahn Reb., GCI Ex. 6.0 REV, 21:512-517.

VII. NEW RIDERS

A. Overview

Both Staff and the AG undertake extensive discussions and analyses which purport to set forth the law in Illinois as to when riders may be appropriately employed and why those parties believe the Utilities' rider proposals do not meet the judicial prescriptions. While the discussions by Staff and the AG include the seminal cases respecting riders and rider treatment of utility costs in Illinois, the specific discussions and analyses of those cases by Staff and particularly the AG, are rife with omissions, flawed analysis and unreliable assertions.

As the Utilities noted in their Initial Brief, NS-PGL Init. Br. at 109, it cannot be seriously argued that the employment of riders in Illinois is not a long standing, lawful and frequently employed practice. As far back as *City of Chicago v. Illinois Commerce Comm'n*, , 13 Ill. 2d 607, 608-609, 614 (1958) ("*City of Chicago*") the Illinois Supreme Court held that the Commission has broad powers under the PUA to implement utility rate and investment mechanisms, including automatic adjustment clauses, or riders.

Two of the more recent judicial decision pertaining to riders, enunciate the Illinois parameters and address those traditional constraints pertaining to retroactive and single issue ratemaking, as well as test year adherence. These cases, *A. Finkl & Sons Co. v. Illinois Commerce Commission*, 250 Ill.App.3d 317 (1993) ("*Finkl*") and *Citizens Utility Board v. Illinois Commerce Commission*, 166 Ill. 2d 111 (1995) ("*CUB I*"), establish that, where warranted, the Commission may employ riders and that the costs that warrant that rider treatment are generally costs that are outside the control of utilities.

A correct reading of *Finkl* reveals that the Court was careful to uphold the principle that riders are an important tool in Commission ratemaking:

> Riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses.

Finkl, 250 Ill. App. at 327 (emphasis in original). *Finkl* provides the most succinct and aptly descriptive recitation of the central analysis that must be made to determine whether rider treatment is warranted. This analysis centers on the controllability and predictability aspects of the costs in question. As to the costs which were at issue in *Finkl*, the court stated:

> Such costs reveal no greater potential for unexpected, volatile or fluctuating *expenses which Edison cannot control*, than costs incurred in estimating base ratemaking. In contrast, costs over which Edison does not have control, exemplified by fuel costs, may be reflected automatically in a different rider, the Electric Fuel Adjustment Clause, Rider 20. Here, *any lack of certainty in predicting costs* would be ameliorated by the aggregate costs and revenues method of balancing now followed in setting base rates.

Id. (emphasis supplied). It is thus apparent that the focus of any determination as to whether a rider is warranted should be on whether the costs in question can be controlled by the utility or whether those costs can be predicted with any certainty.

The accuracy of *Finkl's* description of the test for whether costs are appropriate for rider treatment is borne out in the two other cases decided after *Finkl* that offer analysis concerning which costs warrant rider treatment. *See*, e*.g.*, *Central Ill. Light Co. v. Illinois Commerce Comm'n* ("*CILCO*"), 255 Ill. App. 3d 876 (3rd Dist. 1993), *affirmed in part and reversed in part on other grounds*; *CUB I*; *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill. App. 3d 617 (1st Dist. 1996) ("*City of Chicago II*"). In fact, in *City of Chicago II* the court observed, after validating the criteria of "unexpected, volatile and fluctuating", that riders are not limited "to those instances where costs are unexpected, volatile or fluctuating." *Id*. at 628.

In the general analyses and reviews of riders in Illinois, the Courts have utilized several terms to describe the rider qualification criteria, all of which relate to whether the costs included in the rider are controllable or can be predicted with any certainty.[18] The terms used have included: unexpected, unforeseeable, volatile, uncertain and fluctuating. The common theme and implied analytical framework is quite apparent and commonsensical. If a utility cannot control or predict costs with any certainty, they may be eligible for rider recovery upon a proper showing. When the utility is able to control costs or reasonably predict them, they are more appropriately suited to base rate treatment.

The costs recoverable under each of the riders proposed in these proceedings all share the characteristics of not being controllable by the Utilities and not being predictable with any certainty. Furthermore, the costs covered by the proposed riders also exhibit the characteristics of volatility and fluctuation. How each rider specifically meets the justification warranting rider treatment will be discussed further in the sections of this brief pertaining to the individual riders.

The opponents of the proposed riders also make arguments that the proposals violate the prohibitions against single issue and retroactive ratemaking as well as the Commission's test year rules. The issue of whether a rider is violative of the single issue and retroactive ratemaking proscriptions has been litigated in Illinois and the Courts have made it clear that riders do not violate those proscriptions. *See CUB I*; *City of Chicago II*. Riders have been generally determined not to be single issue ratemaking. As the Illinois Supreme Court observed:

[18] At least one court has suggested that "unique" costs are eligible for riders recovery. *CUB I*, 166 Ill. 2d at 137-138.

> [A] rider mechanism merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return. The prohibition against single-issue ratemaking requires that, in a general base rate proceeding, the Commission must examine all elements of the revenue requirement formula to determine the interaction and overall impact any change will have on the utility's revenue requirement, including its return on investment. The rule does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment.

CUB I, 166 Ill. 2d at 138. Similarly, as to the test year issues, the Illinois Supreme Court has been clear that rider does not violate test year prescriptions when it is accompanied by a reconciliation feature:

> [T]he test-year rule seeks to avoid a problem not present when expenses are recovered through a rider. The reconciliation formula used to determine the amount of the rider charge includes a matching of costs incurred with revenue realized.

Id. at 140. Each of the proposed riders contains a reconciliation feature and thus falls within the holding in the C*UB I* case.

The arguments that the riders constitute retroactive ratemaking are similarly unavailing. It is clear that the opponents of the rider proposals in these proceedings cannot argue that riders are not a common feature in Commission ratemaking and that rider mechanisms have been consistently reviewed and upheld by the Illinois courts. In upholding riders, the Illinois courts have also held that riders do not violate test year rules or proscriptions against single issue and retroactive ratemaking. To the extent retroactive and single issue ratemaking and test year issues are raised in any substantive manner by the parties in respect of a specific rider, those issues will be addressed in the discussion pertaining to the specific rider.

The arguments opposing the implementation of new riders on the grounds that they would impose administrative burdens on the Staff and others are ill conceived. Likewise, are arguments that if the Utilities are granted authority to implement new riders, other utilities across the state will seek to do the same. The fact of the matter is that there is no legal basis whatsoever for the Commission to reject a utility rate proposal simply because it would present work for the Commission, its Staff or other parties. Indeed, it is the Commission's legal responsibility to fully and objectively carry out its responsibilities under the PUA. 220 ILCS 5/9-201. The Commission should not allow the Staff or other parties to cause it to abdicate its statutory responsibilities because those parties fear the amount of work it might take to carry out those responsibilities.

Riders UBA, VBA, and EEP are simply mathematical calculations requiring relatively minor annual auditing procedures. The formulas for those riders have already been developed and any reviews would likely be routine and non-controversial. Rider ICR would involve more review because of the capital expenditures involved, though it would not necessarily be more time consuming or complex to administer than other riders. In the most recently decided gas cost recovery cases for the Utilities, more than a billion dollars of gas costs were audited and approved. As noted by the Attorney General (AG Init Br. 95), the most that would ever be recovered under Rider ICR would be approximately $18.5 million, or less than 2% of the cost recovered under the PGA rider. The Utilities hope that the Commission Staff would spend a proportionate amount of time on the Rider ICR as it does on the PGA rider. Therefore the amount of time required for Rider ICR should be less than 2% of the time required for the PGA rider. Moreover, Rider ICR capital expenditures will be reviewed on an ongoing basis, thus avoiding the need to review these costs when the company files a general rate case. The particular steps that will be required to administer the new riders proposed by the Utilities would be neither complex, novel or particularly time consuming and riders are so widely used by Illinois utilities that the Utilities' riders should not be singled out for discriminatory treatment.

B. <u>Rider VBA and Rider WNA</u>

Aside from the legal arguments raised in opposition to riders in general[19], City-CUB, AG and the Staff have raised objections to the specifics of Rider VBA and questioned whether Rider VBA comports with the legal criteria for Riders in Illinois. In its simplest form, Rider VBA is a rate mechanism which will enable the utilities to adjust their rates monthly to account for the effects of weather and conservation on the portion of margin revenues to be recovered through volumetric charges. Under Peoples Gas' and North Shore's Rider VBA adjustments would be determined for Service Classifications ("S.C.") Nos. 1N, 1H and 2 on a monthly basis to account for the difference between the baseline distribution margin revenue per customer level established in these cases and the actual distribution margin per customer actually experienced in the second month prior to the effective month of the adjustment.

A common theme expressed by several parties is that the definition of "margin revenues" is not clear. Mr. Feingold has clarified that margin revenues means the Utilities' total cost of service, exclusive of purchased gas expenses and "flow-through" items. PGL Ex. RAF-1.0, 15:298-300. Margin revenues is the equivalent of total distribution revenues, base revenues, or the revenue requirement. For consistency, the term "Margin Revenues" is best utilized for purposes of discussion of the Utilities' Rider VBA proposal, with the understanding that the Rider involves the portions to be recovered through volumetric charges. The following is a discussion which addresses the arguments raised by Staff, AG and City-CUB in opposition to Rider VBA.

---

[19] The Utilities' discussion of why their Rider proposals are legally sufficient is set forth in Section VII(A), *supra*.

1. **Rider VBA Does Not Contravene Legal Principles Of Ratemaking**

The AG makes the sweeping argument that Rider VBA violates long standing U.S. Supreme Court authority, citing several of the seminal cases on utility ratemaking, including, *e.g., Bluefield Waterworks Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 279 (1923) ("*Bluefield*") and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 1941) ("*Hope*"). The AG's argument is entirely misplaced and is an attempt to assert the applicability of legal authority involving utility earnings when the express purpose of Rider VBA is to adjust the Utilities' rates to account for margin revenues and not earnings or return on equity.

Margin revenues and a utility's return on earnings are entirely distinct concepts and cannot be arbitrarily lumped together or used interchangeably. Neither *Bluefield*, *Hope* or any of the other cases cited by the AG for the proposition that Rider VBA violates U.S. Supreme Court prescriptions (*see* AG Init. Br. at 41-45) proscribe a decoupling mechanism or the recovery of margin revenues through a rate adjustment mechanism. Rather, those cases address the parameters of utilities' rights respecting "return" and "earnings". In *Bluefield*, the Court clearly spoke to "a utility's rate of return" and permitting the utility to "earn a return on the value of the [utility] property" and "rights to profits". *Bluefield*, 262 U.S. at 692-693. The AG even refers to these concepts in its discussion of *Bluefield*. AG Init. Br. at 42.

Similarly, *Hope* speaks to "net revenues" and "return to the equity owner".[20] It is perfectly clear that the cases cited by the AG involve the establishment of overall utility earnings and not operating revenue. Moreover, the cases only describe the parameters for the

[20] *Hope* actually points out the distinction between earnings and other elements of a utility's business when the Court notes that "[f]rom the investor or Company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business." This observation actually supports the proposition that a utility should be allowed to recover its margin revenues.

establishment of return by regulators. They most assuredly do not "suggest" or otherwise offer guidance in respect of whether a utility ought to be able to recover its margin revenues through operation of Rider VBA, as urged by AG, *See* AG Init. Br. at 44, and this Commission should reject theAG's exaggerated pronouncement that approval of Rider VBA would be tantamount to rejection of the most well established utility ratemaking principles. *Id*. at 44-45.

The opposing parties generally urge that Rider VBA is legally insufficient as a rider in Illinois. This argument must be disregarded. As noted in Section VII(A) *supra*, the Illinois Courts have made it crystal clear that riders are lawful rate mechanisms where warranted. The Courts have not employed any rigid, inflexible framework to tie the Commission's hands in its determinations to employ riders. Generally though, a rider is appropriate where costs are, among other things, a volatile, difficult to forecast, unexpected or fluctuating.

The evidence submitted by the Utilities demonstrates that for the past three years, margin revenues have been highly variable and declining in relation to approved margin levels, Feingold Reb., NS-PGL Ex. RAF-2.0, 8:154-10-182; NS-PGL Ex. RAF-2.1; Borgard Dir., PGL Ex. LTB-1.0 LTB-1.0 REV, 17:380-382; Borgard Dir., NS Ex. LTB-1.0 REV, 16:343-345. This indicates that once margin revenues in this case are established, they will likely fluctuate considerably due to the impact of weather variability and customer usage impacts caused by general conservation, as well as the new energy efficiency programs that Rider EEP is designed to address. Margin revenues cannot be forecasted with any certainty because they are subject to those vagaries of weather and conservation. Hence, it is clear that the Utilities' margin revenues are fluctuating, could be volatile, and often vary from the weather normalized and static levels set in a rate case proceeding. Such characteristics bring Rider VBA well within the tests Illinois courts, including the *Finkl* Court, have contemplated as sufficient justification for Rider treatment. *See, CILCO,* 255 Ill.App.3d at 885. Contrary to the assertions of AG, the changes in the Utilities' margins have not been "gradual". AG Init. Br. at 46. The margin changes have been dramatic and significant and easily justify rider treatment.

Staff and the AG criticize Rider VBA as a form of retroactive ratemaking. Staff states that "rather than provide for the recovery (*sic*) a particular operating expense, Rider VBA seeks to guaranty (*sic*) revenue levels and earnings". Staff Init. Br. at 166. Staff further states that "Rider VBA takes the revenues that the rates approved in a base rate proceeding were intended to recover (which includes the Company's authorized return on rate base), and provides a surcharge if those rates produced insufficient revenues or a credit if those rates produced surplus revenues", contrary to the rule against retroactive ratemaking. *Id.*

Staff's argument is based upon incorrect factual premises and misplaced logic. First, by stating that Rider VBA seeks to "guaranty" revenue levels, Staff is simply stating a tautology: Riders guarantee recovery of what they are supposed to guarantee recovery of. The second half of the statement, that "Rider VBA seeks to guaranty … earnings" is unsupported in the record. The reason it is unsupported in the record is it is simply wrong. Rider VBA is only intended to recover those distribution margin revenues to be recovered through the applicable volumetric charges, approved in the proceeding, based on the number of customers underlying the rates set in this proceeding, no more and no less.

Furthermore, Rider VBA is not intended to address utility earnings at all.[21] Rider VBA is a revenue recovery mechanism and not a cost recovery mechanism that adjusts for changes in the Utilities' costs. Rider VBA would only allow for recovery of that portion of margin revenue

[21] In the testimony and brief of several parties, they have sought to focus the analysis of Rider VBA on the Companies' earnings history. *See*, *e.g.*, AG Init. Br. at 41-45. As is discussed in Section VII (A) *supra*, this focus is improper.

associated with the Utilities' volumetric distribution rates and has nothing to do with how costs change over time and how costs affect the Utilities' returns. Feingold Reb., NS-PGL Ex. RAF-2.0, 8:147-153. To state that Rider VBA seeks to guaranty or otherwise recover "earnings" is simply factually false.

While Rider VBA determines adjustments that will be billed to customers, it does not change the final rates established in the final Commission order in these rate cases. Rather, Rider VBA is a means of lending more assurance that the applicable margin revenues that are a component of the overall revenue requirements of the Utilities are not over or under-recovered. The adjustments which would be entailed by Rider VBA would not modify the just and reasonable rates established by the Commission. Rider VBA adjustments would involve no determination of an excessive or insufficient rate. Rider VBA does not therefore violate the retroactive ratemaking prohibition under *Business & Professional People For The Public Interest v. Illinois Commerce Comm'n,* 136 Ill.2d 192, 209 (1989), or *Citizens Utilities Co. v. Illinois Commerce Comm'n*, 124 Ill.2d 195, 207 (1988).

Likewise, *Illinois Bell Tel. Co. v. Illinois Commerce Commission*, 203 Ill. App. 3d 424, 436 (2d Dist. 1990) ("*Illinois Bell*"), does not apply. *Illinois Bell* involved an incentive rate mechanism which would actually have changed the return on equity which was initially determined by the Commission upward or downward depending on circumstances. First, as discussed earlier in respect of *Hope* and *Bluefield*, margin revenues and return on equity or earnings are entirely different measures. Thus, *Illinois Bell* is distinguishable on this point alone. Second, the Rider VBA adjustment would not at all change the revenue requirement determined by the Commission in any final rate order. As noted earlier, it would also not determine an adjustment for any changes in utility costs. Rather, the Rider VBA adjustment would more specifically only involve an assessment of whether the Commission approved revenue requirement (the applicable portions of margin revenues) is appropriately recovered on a monthly and annual basis. There would be absolutely no change in the rates established by the Commission in these proceedings and Rider VBA would only recover the margin revenues that the Commission intended to be recovered. It is patently false that Rider VBA would guaranty "recovery of the rate of return embedded in [the] revenue requirement," as asserted by Staff. Staff Init. Br. at 167. It is equally false that Rider VBA turns on any "assessment of whether the rates approved by the Commission turned out to be too low or too high." *Id.*; AG Init. Br. at 58. The assessment against which any Rider VBA adjustment would be made turns on whether the Commission determined applicable margin revenue requirement is met in a given month, not whether the applicable margin revenue requirement is too high or too low. Staff's and the AG's mischaracterization of the operation of the Rider VBA must be disregarded along with the argument that *Illinois Bell* applies to Rider VBA. Simply put, Rider VBA does not constitute retroactive ratemaking because it does not change any Commission determined rate after the fact. Since there is no retroactive ratemaking in the operation of Rider VBA, the cases proscribing retroactive ratemaking do not apply.

Staff also makes the completely erroneous argument that Rider VBA violates the prohibition against retroactive ratemaking by assuring the recovery of volumetric-related revenues (irrespective of any actual reduction in demand). Staff Init. Br. at 168. Staff bases its argument on the assumption that Rider VBA is only intended to recover fixed costs. Nothing could be further from the truth. The Utilities have unequivocally established that Rider VBA is intended to recover the applicable portion of the Utilities' margin revenues requirements, with no regard as to whether those revenues arise from fixed or variable costs. As noted earlier, Rider

VBA would allow for recovery of that portion of margin revenues associated with the Utilities' volumetric distribution rates. The Utilities' volumetric distribution charges recover variable costs, which are minimal, as a well a significant portion of fixed costs, hence the need for Rider VBA. As the Utilities' costs are nearly 100% fixed, Staff's argument is moot. Grace Dir., PGL Ex. VG-1.0 REV, 8:171-174 and 18:392-398. Grace Dir., NS Ex. VG-1.0.2 REV, 6-7:131-134 and 16:342-345. Similarly, Staff's interjection of any Rider VBA tie to "reduction in demand" or the fixed/variable nature of costs is arbitrary and should be disregarded.

Staff's and AG's arguments that Rider VBA amounts to single-issue ratemaking are also unavailing. First, as was the case with the so-called "guarantee" feature discussed above, a rider necessarily involves a focus on one element of a utility's costs and can always be negatively criticized as "single issue" focused. This does not mean that a rider *ipso facto* is single issue ratemaking, evidenced by the fact that the Commission and the courts have upheld riders in the face of single issue ratemaking arguments. See, *CUB I, supra*. The *CUB I* case does not stand for the proposition that a rider *ipso facto* violates the rule against single issue ratemaking, unless the costs at issue are "unique", as suggested by Staff. Staff Init. Br. at 169. In the *CUB I* case, the court expressly repeated the long-standing rule that the PUA, taken as whole, does not limit the Commission's power to setting a mere charge or a particular rate, but grants the Commission very broad power to change any part of a rate that affects rates in any manner, including the employment of riders where appropriate. *Citizens Utility Board*, 166 Ill.2d at 138.

In *CUB I,* the court rejected the argument that use of a rider amounted to single issue ratemaking. In upholding the use of a rider in the case, the court pointedly noted that in contrast to single issue ratemaking, "a rider mechanism merely facilitates direct recovery of a particular cost, without direct impact on the utility's rate of return." *Id.* at 138. As earlier pointed out, the court went on to describe the circumstances where the single issue ratemaking concern arises:

> The prohibition against single-issue ratemaking requires that, in a general base rate proceeding, the Commission must examine all elements of the revenue requirement formally to determine the interaction and overall impact any change will have on the utility's revenue requirement, including its return on investment. This rule does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment.

Id. Thus, it is abundantly clear that the Commission has not only broad powers to employ riders, but that riders in themselves do not constitute single issue ratemaking. The *CUB I* Court upheld the use of a rider and merely used the term "unique" to describe the environmental clean up costs at issue. The Court was certainly not interposing a condition that a rider only withstands single issue ratemaking scrutiny where the costs at issue are "unique". Such a pinched reading of the case would be at considerable odds with the broad authority given to the Commission by *City of Chicago* and upheld repeatedly, including in *CUB I*.

In general, Staff is attempting to draw fine, but irrelevant and specious distinctions[22] relative to when a rider may be legally employed and for the sole purpose of attempting to except Rider VBA from inclusion. The more forthright and apt view is that the operation of Rider VBA or any other rider does not necessarily result in retroactive ratemaking or single issue ratemaking. Indeed, Rider VBA is an appropriate means of adjusting the Commission determined Margin Revenue requirement to ensure that the requirement is met. Margin revenues have been demonstrated to be fluctuating and unforeseeable because they are dependent upon the effects of weather and conservation related usage declines and as the *CUB I* court noted:

[22] For example, Staff makes the curious logical leap that because the Companies uses the term "incentive" to describe its motivation to promote energy efficiency, to conclude that the Companies are seeking "incentive based regulation" in order to bring Rider VBA within the factual framework of *Illinois Bell* and *Finkl*.

> [A] rider mechanism is effective and appropriate for cost recovery when a utility *** is faced with unexpected, volatile, **or** fluctuating expenses.

Id. (emphasis added.) The use by the Illinois Supreme Court of the conjunction "or" indicates only one factor need be proved. Margin revenues are both fluctuating and unforeseeable, so they clearly qualify for rider treatment.

The AG argues that Rider VBA violates Section 8-401 of the PUA, 220 ILCS 5/8-401. The AG cites certain amounts that it suggests might represent Rider VBA rates and asserts the bald conclusion that "Rider VBA's monthly adjustment of customer rates will not produce rates that are least-cost, as required by the Act." The AG's least-cost assertion offers no explanation as to how merely stating an amount as comprising Rider VBA rates renders those rates as not being "least cost". The AG does not even make the effort to explain how and in what manner Rider VBA rates are pertinent to a least cost analysis. The argument is so vague and ill-conceived that it should be entirely disregarded, because its just or reasonable foundation cannot be evaluated.

2. <u>Company Arguments Support Rider VBA</u>

The Staff makes numerous exaggerated and unsupported arguments concerning Rider VBA. Staff incorrectly claims that Mr. Feingold's assertion that Rider VBA will reduce volatility is not "necessarily" true. Staff attempts to prove its point by positing an example of a warm December and a cold February to illustrate an upward spike in bills. Staff's scenario is highly contrived. It is just as plausible that there could be a cold December and a warm February which would result in a downward spike in bills, or a cold December which would offset a cold February bill. In fact any combination is plausible in a given set of three months, but over the long term, such spikes have not been established to occur. Staff Init. Br. at 170. Staff concedes that in the longer term, Mr. Feingold's volatility argument is correct.

Staff asserts that the Utilities' ten year weather normalization proposal and increased customer charge proposals will "profoundly" impact customer bills. Staff Init. Br. at 171. Staff offers absolutely no support in the record for how it arrived at the conclusion that such an impact would result, and it appears to have been made simply to cast a negative light on Rider VBA. Similarly, the Staff dismisses Mr. Feingold's arguments that the weather normalization and customer charge proposals do not undermine Rider VBA as "half-hearted" with no explanation as to why and ignoring additional record evidence that weather normalization and increased customer charges give the Utilities a better opportunity to recover Margin Revenues. Grace Dir., PGL Ex. VG-1.0 2REV, 18:392-398.

Staff incorrectly asserts that the "evidence" demonstrates that ratepayers are highly motivated to conserve and do not require any additional assistance from the Utilities to reduce consumption. Staff cites no record evidence, or other support for the proposition because no evidence to that effect is in the record. Staff makes the fallacious argument that because ratepayers "significantly" reduced gas consumption over the past twelve years, the Utilities were unable to induce them to consume more and thus there is no reason they will be able to motivate ratepayers to use less gas in the future. That argument completely ignores the affirmative role the Utilities could play in promoting energy efficiency, not only through the promotion of programs such as those related to Rider EEP, but through other conservation efforts as well. Rather than place the focus on such constructive efforts, the Staff makes the curious suggestion that the Companies should have fallen on their swords by proposing a rate design that recovers a larger share of costs through usage charges, rather than fixed customer charges, placing the Companies more at the mercy of weather and declining customer usage, and making it less likely the company will encourage conservation in the future.[23] Finally, it should be noted that the level of the customer charge and the volumetric distribution charges would diminish in importance if Rider VBA is implemented because Rider VBA would assure greater recovery of the applicable revenues.

Staff's argument does highlight the win/lose nature of the current rate structure. The Company could encourage greater conservation through rate design, but only by sacrificing the interests of the Company. Lowering the fixed charge would indeed promote conservation by customers, but only at the expense of the Companies. Rider VBA cuts through this conundrum. With a Rider VBA, the Companies would be at worst indifferent and at best supportive, of all methods of promoting reduced customer usage, including changes to rate design.

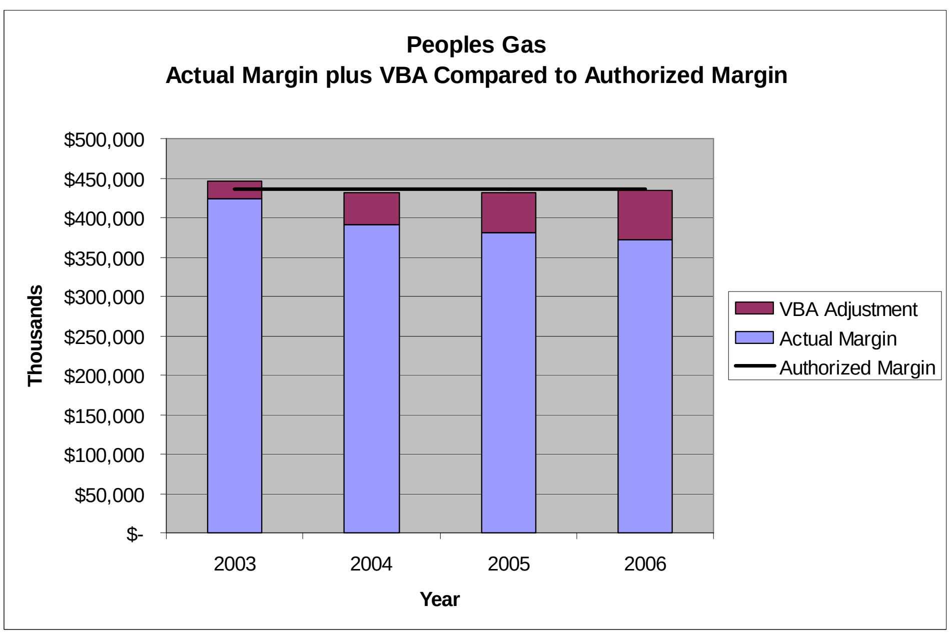
The Staff attempts to exaggerate the impact of Rider VBA by citing gross margin impacts for the five year period 2002 through 2006. Staff Init. Br. at 156-157. A more apt reference would be to Mr. Feingold's demonstration of per customer rate impacts. Mr. Feingold testified that during such periods the per customer impact of Rider VBA would have been only about $3.00. Feingold Dir., PGL Ex. RAF-1.0, 34:671-676.

Staff makes a great deal of how much customers would have paid had Rider VBA been in effect. Staff Init. Br. 156. What the numbers cited by Staff do show is how VBA simply recovers the margin revenues included in the last rate case. The graph below takes the information provided in Staff's Initial Brief, p 156 and combines it with the information contained in NS PGL Ex RAF 2.1, page 2 of 3.

[23] Staff's observation is particularly puzzling in light of Staff's support of increases in customer charges and the overall concept of recovering more fixed costs in customer charges.

Peoples Margin Revenues			
FY	Actual (1)	VBA Adjustment (2)	Rate Case (1)
2003	$ 424,511.00	$ 22,261.00	$ 435,502.67
2004	$ 391,161.00	$ 39,568.00	$ 435,502.67
2005	$ 381,320.16	$ 50,617.00	$ 435,502.67
2006	$ 371,858.94	$ 61,899.00	$ 435,502.67
(1) Source: NS-PGL Ex. RAF 2.1			
(2) Source: GCI Ex. MLB 3.1			

North Shore Margin Revenues			
FY	Actual (1)	VBA Adjustment (2)	Rate Case (1)
2003	$ 65,714.00	$ 1,561.00	$ 59,600.43
2004	$ 62,123.00	$ 4,323.00	$ 59,600.43
2005	$ 61,991.12	$ 5,634.00	$ 59,600.43
2006	$ 61,081.14	$ 6,906.00	$ 59,600.43
(1) Source: NS-PGL Ex. RAF 2.1			
(2) Source: GCI Ex. MLB 3.1			



The graph dramatically shows that the additional amounts Staff refers to simply bring the Company's margin revenue back to the Commission authorized margin level.Staff goes on to suggest that margin revenues are "irrelevant in the current regulatory environment" and asserts, without support in the record or otherwise, that rate of return is a "better and broader" measure. Staff Init. Br. at 174-175. From this unsupported assertion, the Staff asserts more improbably that VBA revenues could result in "extraordinary returns at ratepayer expense". *Id.* at 175. Again, Staff offers absolutely no support for this assertion.

3. The Decoupling Cases

The Staff spends several pages quibbling over the number of regulatory bodies involved with decoupling and employing semantic gyrations in an attempt to undermine the validity of decoupling and to deny its increasing application nationwide. For example, Staff states that instead of regulators in ten (10) states adopting decoupling as Mr. Feingold asserts, "four out of five regulatory bodies have failed to adopt revenue decoupling". Staff Init. Br. at 177. This assertion is merely a negative formulation of Mr. Feingold's statement and is misleading because it does not indicate whether those four out of five bodies have even considered revenue decoupling. Furthermore, Staff's pointing out that decoupling has been adopted in various forms by means of settlement, litigation, statute or rulemaking is beside the point. The salient fact is that decoupling, in one form or another, has been consistently and increasingly broadly applied across the nation, as Mr. Feingold has demonstrated.[24] Feingold Sur., NS-PGL Ex. RAF-3.0, 5:90-101. Even during the evidentiary hearing of these proceedings, a decoupling proposal was

[24] Staff also conveniently disregards the evidence that when these proceedings commenced, decoupling had only been approved in nine (9) states and 6 months later when the Surrebuttal Testimony was filed, that number had risen to eleven (11). Feingold Sur., NS-PGL Ex. RAF-3.0, 5:85-99.

approved for a New York utility. *In re Consolidated Edison Co. of New York, Inc.*, NYPSC Docket No. 06-G-1332, at 24, 34-35 (Order, September 19, 2007).

Staff's assertion that states have approved decoupling with "great apprehension"(Staff Init. Br. at 181) is another assertion unsupported by the record. The fact that decoupling may have been employed after investigation or in a pilot context does not evince "great apprehension" – caution or deliberation perhaps, but nothing so dramatic as Staff asserts.[25]

It is an inescapable conclusion that decoupling is becoming increasingly employed by regulators across the nation to address the challenges of environmental impacts and changing usage patterns and their impacts on utilities. Decoupling is not the bogey man that certain parties have attempted to portray it. Rather, it is a viable and legally defensible ratemaking tool that timely addresses the ratemaking challenges of nature.

Another example of Staff's exaggerated or misstated claims pertains to the Utilities' financial success. In order to diminish the Utilities' demonstration of business challenges, Staff asserts that the "available evidence indicates that Peoples Gas and North Shore have achieved sustained success in recent years". Staff Init. Br. at 181. As support for this argument, Staff incorrectly asserts that the Utilities have "consistently met or exceeded their approved rates of return…for a full decade after…1995." Staff Init. Br. at 182. The record is clear and Mr. Borgard's testimony, PGL Ex. LTB-1.0 REV, belies this statement by reflecting that in the three most recent years, 2004, 2005, and 2006, Peoples Gas did not meet or exceed its rate of return and in fact significantly underearned in these years. Borgard Dir., PGL Ex. LTB-1.0 REV, 9:188-196; Borgard Dir., NS Ex. LTB-1.0 REV, 8:176-9:185. Thus, to characterize the

[25] Staff also criticizes Rider VBA for not allowing the Commission to review its effectiveness before the Company files another rate case or otherwise limit its application. Staff Init. Br. at 181. The Company accepted Ms. Hathhorn's proposed annual review. Staff did not propose a more comprehensive review. If Staff believes something more was required, it could have proposed changes to the rider.

evidence of the Utilities' financial health as "clear and straightforward" is revealed as a misplaced attempt to discredit evidence that Staff finds unpalatable, *i.e.*, that the Utilities' financial health has indeed been in decline largely due to weather and consumption variations that would be addressed through Rider VBA. No amount of redirecting the focus of discussion to earning approved rates of return and references to misapplied Commission precedent changes that crucial reality. Moreover, to continually harp on what earnings may have resulted nine or ten years ago is backwards-looking and does not consider the recent past and the future, the most relevant periods for analysis. By attempting to cast numerous aspersions on various isolated statements which support Rider VBA, Staff is attempting to obscure the essential facts. These are that the Utilities have experienced considerable financial distress in the recent past, that this has occurred with respect to both margin revenues and return on equity and that the factors causing this distress relate to the effects of conservation and environmental factors (mainly weather) and that an appropriate rate mechanism is warranted to address these challenges. Rider VBA is a reasonable means of doing so.

Staff also makes the argument that the Utilities must demonstrate why no other Illinois gas utilities "require this kind of rider". Staff Init. Br. at 187. Obviously, the Utilities are in no position to address the business imperatives of other utilities and this case involves the facts and circumstances present on the Peoples Gas and North Shore systems. There is absolutely no legal or other requirement that a utility must show why other utilities have not proposed a mechanism before the proposing utility may obtain approval to implement a particular mechanism.

Finally, Staff continues to complain about the alleged regulatory burden of administering yet another rider. As was discussed in detail in Section VII(A) *supra*, these arguments should be disregarded.

Rider WNA

Staff makes the same arguments about retroactive ratemaking and single issue implications for proposed Rider WNA and the arguments are no less persuasive for the same reasons stated above. Even though Staff opposes Rider VBA, it makes the curious argument that Rider WNA is deficient because it does not include the adjustment for the impact of conservation that is a part of Rider VBA. Staff takes this curious logic a step further, urging that Rider WNA "undermines the Companies' incentive to encourage ratepayers to conserve". Staff Init. Br. at 185. Rider WNA is clearly designed only to capture the effects of weather and is proposed as an alternative to the broader Rider VBA and Staff knows as much. The Commission should disregard Staff's argument.[26]

C. Rider ICR

Peoples Gas originally proposed Rider ICR. Subsequently, Peoples Gas agreed to numerous modifications of Rider ICR, most of which were proposed by the Commission Staff. Staff also recommended the renaming of the rider to Rider QIP. Peoples Gas believes that the term Rider ICR is the term that should be used and for its proposed infrastructure cost recovery mechanism. This is appropriate because it avoids confusion with the Rider QIP that is generally applicable to waste and sewer companies under Part 656 of the Commission's Rules. Retaining the Peoples Gas proposal to call its recovery mechanism Rider ICR also avoids the complication that the features of the Part 656 QIP are necessarily applicable to or appropriate for Peoples Gas or natural gas utilities. In any event, the Company has agreed to the modifications proposed by

[26] Staff also misstates the operation of Rider WNA. Staff indicates that the Companies' WNA would determine adjustments based on the relationship of temperatures in future years to the temperatures in the months of October 2005 through May 2006. Staff Init. Br. at 186. Rider WNA would determine adjustments based on the relationship of temperatures in future years to the *normal* temperatures in the months of October through May, based on the normal approved in this proceeding.

Ms. Hathhorn, except the one pertaining to a return credit. Peoples Gas urges that the original Rider ICR proposal be disregarded and that from this point, the modified proposal become the focus of this proceeding retaining the denomination of Rider ICR. To the extent, however, that elements of the original Rider ICR proposal are necessarily a part of the modified Rider ICR, they are not being abandoned. Otherwise, however, to the extent that arguments raised in Initial Briefs concern the original Rider ICR unmodified, they will not be addressed by the Utilities and need not be addressed by others.

The parties opposing Rider ICR do not appreciate the uniqueness of the CI/DI main situation in Chicago. Mr. Schott submitted an exhibit which vividly demonstrates the extent of CI/DI main present in Chicago, thereby demonstrating the pressing need to modernize those facilities. *See*, Schott Sur., NS-PGL Ex. JFS-3.2. Indeed, there is no question that there is not another municipality in Illinois with the density reflected in NS-PGL Ex. JFS-3.2, and whose gas utility is the age of the Chicago gas infrastructure system. It simply cannot be seriously argued that the situation in Chicago is not unique in Illinois.

Staff and the AG, as well as CUB, level a number of misplaced characterizations concerning Rider QIP and urge flawed legal analyses in support of their contentions. By contrast, the City supports Rider ICR without reservation. The City described the acceleration of CI/DI main replacement as a “significant effort to bolster and improve this critical aspect of Chicago’s infrastructure”. City Init. Br. at 311. The City also acknowledged that Rider ICR will allow Peoples Gas to coordinate with the City and others as they pursue development projects in Chicago without the potential uncertainty that accompanies having to wait until the next rate case to recover the cost of taking advantage of such opportunities. *Id.* The City is the most strategic and pivotal participant, along with Peoples Gas, in the implementation of the accelerated main replacement program. Hence, the City's recognition of the importance of Peoples Gas' effort to modernize the utility infrastructure in the City is of major significance. As a major customer of Peoples Gas, the City's support is even more compelling.

The AG argues that the benefits of Rider ICR are not necessary because they are occurring under the existing replacement program and are not necessary for the maintenance of a safe and reliable system. AG Init. Br. at 86-88. Staff makes a similar argument when it urges that the purpose of the accelerated approach is not to provide any new or enhanced service to ratepayers and suggests that Peoples Gas is seeking to have ratepayers pay an extraordinary price for ordinary gas service. Staff Init. Br. at 192. In making such assertions, the AG and Staff simply refuse to acknowledge that the purpose of accelerating main replacement is to go well beyond the extent and pace of current infrastructure replacement. The purpose of Rider ICR is to considerably reduce the approximate 40 year completion time frame for main replacement by doubling the rate of CI/DI replacement from the current 30 to 50 miles annually to 60 to 100 miles per year, as noted by Mr. Schott. Schott Tr. at 1550:19 – 1551:7. Focusing on the attributes of the existing program mischaracterizing the accelerated program, as AG and Staff do, should not be allowed to detract from this plain and straightforward purpose of the acceleration of CI/DI main replacement which Rider ICR would permit.

Aside from ignoring the clear purpose of the accelerated approach to main replacement, the parties who oppose it have very carefully side-stepped the matter of the need to modernize and enhance the utility infrastructure in the City of Chicago. The City and Peoples Gas have both urged that the replacement of piping and associated infrastructure that is in some cases over one hundred years old, is crucial. No party has argued that there would be a more reasonable means of accelerating main replacement and providing Peoples Gas with the necessary financial assurance.

In a similar vein, the parties who criticize Rider ICR point out that coordination with the City is a long standing practice of Peoples Gas. AG Init. Br. at 87; Staff Init. Br. at 193-194; CUB Init. Br. at 10. The salient point, however, is not that Peoples Gas has not been coordinating with the City and others in the past. The crucial point, as Mr. Schott points out, is that Rider ICR will allow Peoples Gas to engage in even more coordination with the City and third parties to pursue development projects that will permit CI/DI main replacement much sooner than would be the case without acceleration and Rider ICR. Schott Dir., PGL Ex. JFS-1.0, 10:224-11:231. Otherwise, it is simply infeasible to expect Peoples Gas to pursue accelerating main replacement without the financial assurance it needs between rate cases.[27] Similarly, AG's argument that the accelerated program is not tied to any concern with safety or reliability is misplaced. AG Init. Br. at 88. Peoples Gas has never argued that its system is unsafe or unreliable or that the purpose of the accelerated program is to enhance safety or reliability. It bears repeating, the purpose of accelerating CI/DI main replacement is to considerably shorten the time frame by which the entire project could be completed and to substantially improve the gas utility infrastructure in the City of Chicago. There are no issues involving safety or reliability and the replacement of CI/DI mains, either on an accelerated basis or under the existing schedule has no implications for safety or reliability.

[27] Thus, it is unreasonable to expect that Peoples Gas would have earmarked pipe or established a budget for the accelerated program, as suggested by the AG, if the rider itself has not yet been approved. AG Init. Br. at 88.

1. **<u>Rider ICR Rates</u>**

The AG, Staff and CUB criticize various aspects of the specific rate design of Rider ICR.[28] Those concerns generally fall into three categories: (1) criticism that O&M and other productivity savings are not accounted for in Rider ICR; (2) allegations of risk shifting; and (3) the failure to adopt Staff's return credit proposal.

Rider ICR does not attempt to adjust the Company's rates to account for various possible cost savings which might arise from the installation of CI/DI replacement mains. The parties take issue with Peoples Gas' position not to adjust Rider ICR for tax effects, earnings impacts, and operations impacts. AG Init. Br. at 91; Staff Init. Br. at 198-202; CUB Init. Br. at 11-12. Mr. Schott was very clear that to interject adjustments for all of the potential impacts that CI/DI main replacement might entail would unnecessarily complicate the recovery mechanism and defeat the very purpose of the rider. Mr. Schott further pointed out that all such savings will eventually be accounted for when Peoples Gas files the rate case following their installation. Thus, any issue pertaining to savings associated with CI/DI main replacement largely centers around timing. Mr. Schott specifically stated:

> [T]he introduction of requirements to give rate effect to values, such as tax effects, rate of return impacts and other such measures, would most certainly add a level of complexity to [Rider ICR] that is unwarranted. Consideration of all of the variables that might be impacted by the installation of CI/DI replacement facilities is a task which can only be accomplished realistically in a general rate case proceeding. The purpose of Rider ICR is to give the Company a means of recovering its costs **between** rate cases.

Schott Sur. NS-PGL Ex. JFS-3.0, 4:65:71 (emphasis added.) Thus, Peoples Gas has made it clear that to attempt to adjust Rider ICR for the impacts it might have on other aspects of costs

[28] The Staff makes a passing reference to Rider ICR requiring customers to pay for costs between rate cases. Staff Init. Br. at 193. A rider by definition, of course, does so and this feature should have no bearing on the propriety of a rider. CUB makes arguments concerning a purported administrative burden which Rider ICR would impose. CUB's arguments are addressed in Section VII(A) *supra*, concerning all parties' objections to riders on the basis of administrative complexity and burden.

would be tantamount to a rate case. Mr. Schott, nevertheless, conceded that there are certain impacts which are more readily susceptible of quantification, such as leak savings and deferred tax effects. Mr. Schott submitted evidence indicating that each mile of replacement pipe might yield $3,000 in annual leak repair savings. Schott Reb., NS-PGL Ex. JFS-3.0, 8:166-9:175; NS-PGL Ex. JFS-3.1.

Although the argument has been made that Rider ICR will cause a shift of risk from the Company to the ratepayers, this argument is unpersuasive and unsupported by the record**,** Rider ICR is intended to recover the costs of CI/DI main replacement for which customers will pay whether it occurs under the accelerated approach or under the current replacement program. By accelerating the time frame over which the main replacement occurs, no shift in relative risks occurs. Only the time frame in which expenditures are incurred will change. It should also be noted that the arguments that Rider ICR will undermine Peoples Gas' incentive to control costs (*see* Staff Init. Br. at 195) are unpersuasive.[29] Only Staff has addressed this issue.

Although the parties have urged in their Initial Briefs that Ms. Hathhorn's revenue credit proposal be adopted, no witness except for Ms. Hathhorn has submitted any evidence that establishes why the credit is needed. Even Ms. Hathhorn does not submit facts to support her opinion that "if the Company is exceeding its authorized overall rate of return, there is no reason not to implement this credit provision…." Hathhorn Reb., Staff Ex. 13.0, 19:409-20:411. Thus, Ms. Hathhorn's evidence is simply little more than her opinion.

Peoples Gas has urged and even Ms. Hathhorn has agreed that the Part 656 framework from which she derives her recommendations for modifications to the Company proposal is

[29] Staff took this position in respect of the original Rider ICR proposal, which involved a base and incremental approach. The Rider ICR proposal does no such thing and Staff does not mention this argument in its discussion of modified Rider ICR. *See* Staff Init. Br. at 195.

merely a “starting point. Hathhorn Dir., Staff Ex. 1.0, 21:445 - 22:455. The particular features of Part 656 are not necessarily appropriate in the context of natural gas utilities or a CI/DI main replacement program as extensive as Peoples Gas’.[30] Only Peoples Gas has established specific factual reasons why a return credit would be inappropriate. Mr. Schott offers several reasons including the addition of unnecessary complexity, and a detailed discussion of the financial consequences of such a credit. Among the latter are elimination of the very recovery which Rider ICR is designed to recover, and the disincentive which it would create to even conduct infrastructure replacement, except when the Company was not earning its full authorized rate of return.

Aside from the utter failure to establish why the credit provision proposed by Ms. Hathhorn is reasonable, the parties who have supported the credit offer only arguments in favor of it that suggest a punitive motive. For example, Staff inexplicably and casually uses terms such as “excess earnings” and “penalty” and “over-earning”, even in characterizing how Peoples Gas itself describes various aspects of Rider ICR.[31] *See* Staff Init. Br. at 200. It is curious indeed and very telling that the Staff characterizes the credit as a “penalty”. Staff Init. Br. at 200. Such a characterization is indicative of the parties’ intent in imposing the revenue credit, to financially penalize Peoples Gas. Indeed, if the credit were reasonable at all, it also would have a feature that would give Peoples Gas some financial benefit when it did not earn its return. It is clear that the parties simply intend to penalize Peoples Gas when it earns above its

[30] In its Initial Brief, Staff attempts to impugn the Company’s rejection of the revenue credit by falsely asserting that Peoples Gas admitted it did not study the credit provision until responding to Staff’s rebuttal testimony. Stt Staff Init. Br. at 199, citing Schott, Tr. At 1646. Peoples Gas made no such admission. Even a casual reading of Mr. Schott’s referenced testimony (Tr. 1646-1647) reveals this.

[31] Obviously the Company would not use such pejoratives to describe its financial results and the Staff’s use of these terms in describing Company characterizations is inappropriate.

allowed return on equity for reasons that have nothing to do with infrastructure replacement, with no corresponding adjustment when Peoples Gas does not earn its allowed return on equity. In short, the credit proposed by Ms. Hathhorn is not supported by the evidentiary record, is ill-conceived and punitive. Peoples Gas, on the other hand, has submitted thoughtful and creditable reasons such a credit would be inappropriate. Therefore, the Commission should disregard Ms. Hathhorn's Rider QIP earnings credit proposal.

2. Legality of Rider ICR

The parties have offered a number of arguments asserting that Rider ICR would be unlawful. The arguments in this regard and the meager authority cited in support of them are not on point. As has been discussed in detail in Section VII.A., the legal criteria for riders in Illinois is well established. Rider ICR would recover costs of the acceleration of infrastructure replacement on the Peoples Gas system. This infrastructure replacement will occur as opportunities present themselves and in amounts that can only be determined once a project has been identified and presumably completed. Thus, it is clear that the costs under Rider ICR are unforeseeable and are not necessarily within the control of the Company if it must coordinate its construction with the City and third parties. Moreover, the circumstances surrounding the City's natural gas utility infrastructure is unique and likely unlike any other Illinois utility. Rider ICR would therefore meet at least two of the tests warranting rider treatment, unforeseeable costs that are difficult to project with any certainty and costs that are out of the control of the Company since their incurrence is based on the actions of others, *i.e.*, the City and third parties. Rider ICR costs might even qualify for rider treatment under the "uniqueness" test cited by the *CUB I* court.

In any event, the Rider ICR costs warrant rider treatment under Illinois law. The circumstances presented are almost identical to those presented in *CUB I* and *CILCO*. It is difficult to imagine a set costs that more squarely warrant rider treatment than the difficult to project, unforeseeable accelerated main replacement costs that may only be incurred when the appropriate opportunities present themselves. The Staff and AG have presented no legal analysis to the contrary.

D. <u>Rider EEP (Merits of Energy Efficiency Programs and Rate Treatment)</u>

1. <u>Merits of Energy Efficiency Programs</u>

Staff is the only party to oppose the proposed Energy Efficiency Program on its merits. The Utilities believe Staff's worries and quibbles are overstated, and can be summed up in one sentence from Staff's brief: "Staff does not support using utility rates to fund conservation programs." Staff Init. Br. at 205. The Utilities believe that the proposed program, borne of their Integrys affiliates' experiences in other states, and of the observation by the Utilities and the Environmental Law and Policy Center as to how programs work in other states, justifies this program as worth undertaking in Illinois.

Staff considers the program "unfair" because not everyone will necessarily participate. Staff Init. Br. at 203. This is a rather small argument. Many things work this way, including almost everything paid for by taxes. Taxes pay for roads that many citizens will never drive on, and fire fighters that most people, thankfully, may never call. Does this make taxes "unfair?" Surely Staff would not take the argument quite that far. Given all the positive effects a well-designed energy efficiency program, it should not be considered so unfair as to be not worth undertaking as long as the benefits are equally available to all customers. The broadly constituted Governance Board, reporting to the Commission, should be able to design a program with broad appeal. *Id*. at 3:57-64.

Staff considers the program "inefficient" because high prices should do the work. Staff Init. Br. at 204. Even with high prices in the near term, some customers will make better choices with an extra incentive. Rukis Sur., NS-PGL Ex. IR-3.0, 2:38-44. Staff seems to assume that the program will result in measures that aren't cost-effective. But if cost-effective measures are chosen – and there is enough experience around the Midwest at this point that good program directors can find such measures – this should not be a real concern. Rukis Sur., NS-PGL Ex. IR-3.0, 3:45-64.

As to governance, Staff complains that it is inefficient. The Utilities do not agree, but ultimately will abide whatever structure the Commission orders. Staff's proposal is for a Director that has central control. That works in some other programs, and the Utilities can live with it. The Utilities' focus in setting up the proposed governance was to place a high value on independence from the Utilities. Rukis Sur., NS-PGL Ex. IR-3.0, 5:90-97. The Utilities understand that many people would feel that the Utilities have insufficient motivation for the program to be successful if they control it. The Utilities proposed governance is not the only way to set up a program, but as proposed, it would be independent.

2. <u>Rate/Rider Treatment</u>

The proposed Rider EEP would allow the Utilities to recover monthly incremental costs associated with the development and implementation of energy efficiency programs on an annual basis. NS-PGL Init. Br. at 133. The Utilities' request to recover EEP costs through a rider should be approved by the Commission.

First, "[r]iders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses". *Finkl*, 250 Ill. App. 3d at 327. Rider EEP costs clearly meet these criteria. Other parties have argued that because the Utilities have agreed to spend $7.5 million, i.e., a fixed amount, that the Utilities cannot utilize a rider to recover these expenses because since the amount is known, it cannot possibly be "unexpected, volatile or fluctuating". AG Init. Br. at 119; Staff Init. Br. at 210-211; City-CUB Init. Br. at 89-90; ELPC Init Br. at 10-11. The Utilities disagree.

In fact, Rider EEP expenses are only known today because the Utilities have agreed to an amount as approved by the Commission. Merger Case Order, *supra* at 2007 WL 713200. Future spending levels, however, are uncertain and have been acknowledged as such. Kubert Corr. Dir., ELPC Ex. 1.0, 6:114-7:116. Although, ELPC does not recommend a rider for recovery of these expenses, Mr. Kubert has agreed that there is uncertainty regarding the levels of expenditure for an EEP program such as the one proposed by the Utilities. NS-PGL Init. Br. at 134.

Further, *Finkl* did not deal "…specifically with the very type of expenditure that Peoples Gas and North Shore would recover through Rider EEP". City-CUB Init. Br. at 89. In *Finkl*, the court reversed the Commission's order which utilized a rider to recover costs associated with demand-side management programs because the Rider 22 expenses in *Finkl* were not deemed to warrant rider treatment because the Court found that the Rider 22 costs "involve payroll …; personnel training, education and travel; contractors and consultants costs; out of pocket promotion and computer costs; and conducting workshops". *Finkl*, 250 Ill. App. 3d at 327. Those costs were within the control of the Utility. Of course, this is not the case with the Utilities' proposed Rider EEP expenditures, which lack the certainty that could be used to predict in advance expenditures from month to month and year to year and may even fluctuate. NS-PGL Init. Br. at 135. Moreover, as discussed in Section VII(A), *supra*, the test of whether a rider is justified centers around whether the costs are controllable or are predictable with any certainty. The expenditure for the energy efficiency program is neither controllable by the Utilities nor predictable with any certainty. The costs are a function of when the Board approves the funding of projects and is a function entirely independent of the Utilities. It is difficult to imagine a category of costs that are so totally out of the control of the Utilities and subject to being expended at times which are dependent upon the actions of third parties. The EEP costs therefore fall squarely into the category of costs that the Illinois courts have found to warrant rider treatment. *CUB I,* 166 Ill. 2d at 1093.

In addition, the Utilities have in the past recovered conservation program costs through a rider under a statewide least cost planning initiative. This certainly is convincing as well as pertinent to why the Utilities proposed having Rider EEP program expenditures recovered through a rider. *Id*. The uncertain timing with regard to forecasting along with the level and incurrence of program expenditures make Rider EEP well suited for rider treatment as the Commission has acknowledged in other cases. NS-PGL Init. Br. at 135.

The Utilities do not believe that the objections raised to their recovery of EEP cost through the proposed tariff rider mechanism are well supported. Nevertheless, the Utilities are willing to accept an annual deferred accounting procedure for handling cost-recovery of energy efficiency programs expenditures if the Commission does not approve the use of a rider to allow for cost-recovery. NS-PGL Init. Br. at 135. The Utilities believe, as is discussed in more detail in Section VII(F),*infra,* that the deferred account treatment is reasonable and lawful.

E. Rider UBA

City-CUB, AG and the Staff have raised various objections and legal arguments opposing the Utilities' proposed Rider UBA. Aside from the legal objections, which will be considered later, the objections fall into three basic categories:

1. Uncollectibles are not volatile.

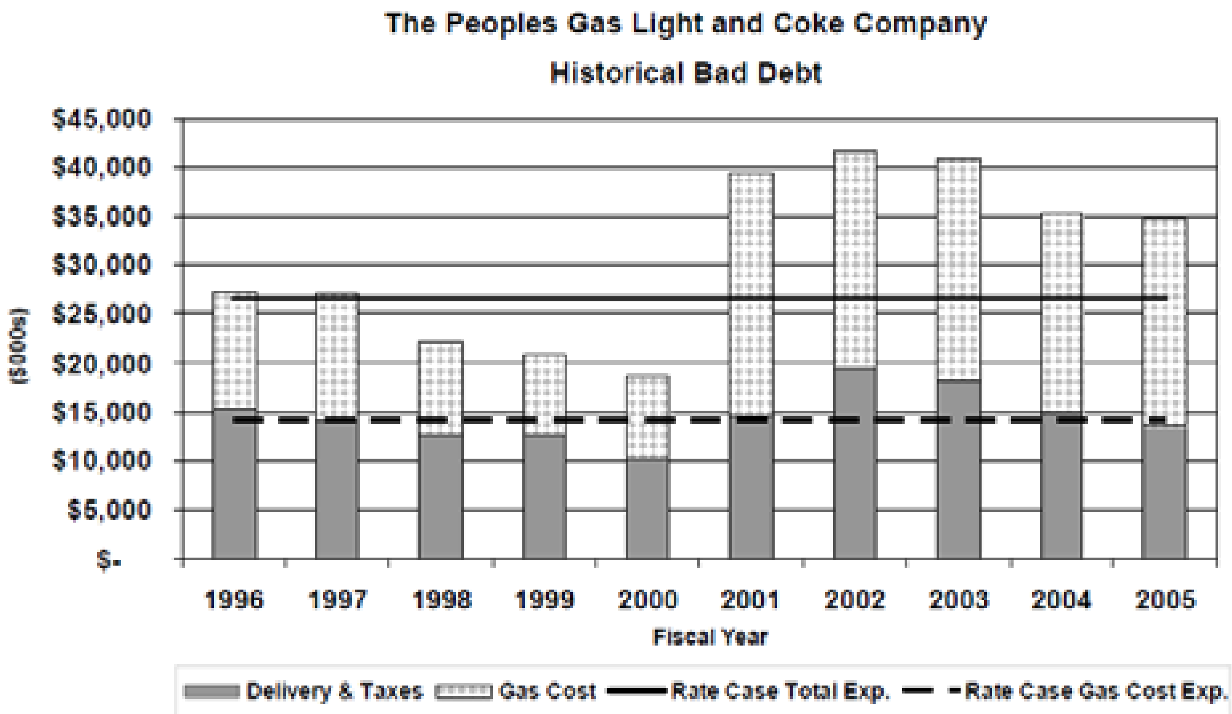
2. Uncollectibles are not beyond the Companies' control.

3. Uncollectibles must be material.

As to the contention that Rider UBA does not meet the legal requirements of a rider, the parties in opposition are incorrect. Despite the protestations to the contrary (Staff Init. Br. at 214-220; City-CUB Init. Br. at 90-92; AG Init. Br. at 124-125), gas cost related uncollectible expense, *i.e.*, the Utilities' bad debt that is to be recovered under Rider UBA, is volatile, fluctuates, is unpredictable and is largely out of the control of the Utilities. While, in order to warrant rider treatment, a cost need only have one of the characteristics that have been enunciated by the courts, the bad debt of the Utilities fits three of the criteria.

Although the parties engage in various degrees of attempting to define the extent of the fluctuation and volatility of the Utilities' bad debt, it is undeniable that the cost has varied considerably. Mr. Borgard submitted evidence that clearly shows that for a 10 year period, annual bad debt has ranged from just under $20 million to over $40 million. *See* PGL Ex. LTB-1.5 depicted below.

Peoples Gas Ex. LTB-1.5



The exhibit also shows that from 1997 to 2000 bad debt trended downward for those four years, spiked from 2000 to 2001, leveled off from 2001 to 2003 and has trended downward and was stable for the two years 2004-2005. Those irregular variations are precisely what the term fluctuation means. The volatility is evinced by the fact that the changes in bad debt levels are irregular, but also that they have comprised changes that represent a doubling of the expenses from time to time.

There can therefore be little debate that bad debt, particularly gas cost related bad debt,[32] represents the kind of costs that warrant rider treatment. The Commission should not allow the

[32] Gas costs, which are unquestionably fluctuating and volatile, are accorded rider treatment. Gas cost related bad debt is directly related to gas costs and should be afforded the same rider treatment.

semantic distortions[33] of the opponents to Rider UBA to obscure this fact.[34] Since the costs that are to be recovered under Rider UBA are fluctuating, volatile and unpredictable, they unquestionably qualify for rider treatment under Illinois law.[35] *See CUB I, supra*; *Finkl, supra*.

The opponents to Rider UBA offer the additional argument that approval of Rider UBA would eliminate the Utilities' incentive to control bad debt costs. Nothing could be further from the truth. First, as has been established on the record, the Utilities would only recover the gas cost related bad debt. Non-gas cost related bad debt would continue to be recovered in base rates. Feingold Dir., PGL Ex. RAF-1.0, 40:795-800; Feingold Dir., NS Ex. RAF-1.0, 37:806-811. The Utilities would thus remain at risk for a portion of bad debt expense which would be considerable incentive to manage bad debt effectively and Ms. Kallas has testified that the Utilities' practices are consistent. Kallas Dir., PGL Ex. LK-1.0, 17:386-18:400. Management of bad debt can only have a limited impact on bad debt losses since ultimately the level of bad debt is dependent upon customer behavior, which is outside the control of the Utilities.

The AG has argued that bad debt does not warrant rider treatment because, in the AG's opinion, the costs involved are insubstantial. AG Init. Br. at 124. First, the AG's argument presumes there is a legal requirement that a cost be of a particular size before it can warrant rider treatment. There is no such requirement. Second, and more importantly, the AG's argument is

[33] For example, AG uses such terms as "limited volatility" and "relatively stable". AG Init. Br. at 125.

[34] It is also clear that bad debt is directly related to gas cost levels which no one can argue are volatile, fluctuating and unpredictable. Given the relationship of the two costs, it is reasonable that both would qualify for rider treatment. *See Finkl, supra* at 327.

[35] While the parties in opposition make conclusory arguments that Rider UBA contravenes the test year rules and is retroactive and single issues ratemaking, their arguments are perfunctory and are misplaced for reasons discussed in Section VII(A) *infra*.

facile and wrongheaded on its face. To suggest that costs that sometimes have amounted to $40 million annually are insubstantial is unreasonable and nonsensical.

The AG also attempts to interject least cost considerations into the discussion of whether Rider UBA is appropriate. AG Init. Br. at 36. While the AG mentions the issue in a section heading, its actual discussion is sparse and, for the most part, speaks to margin revenues and return matters in relation to bad debt, with a single mention of "least cost" in the last sentence of the discussion. The argument must be disregarded for failure of any reasoned analysis or support for the subject matter announced.

In summary, the Utilities have established beyond a doubt that bad debt over the past 10 years has varied considerably and has changed in a fashion that can never be reasonably foreseen. As such, bad debt warrants rider treatment and Rider UBA should be approved.

F. **<u>Deferred Accounting Alternative to Certain Rider Requests</u>**

As noted above and in the Companies' Initial Brief, the volatility, variability, unpredictability and uncontrollability of the costs underlying proposed Riders VBA, UBA and EEP render them appropriate for recovery under the rider mechanisms proposed here by the Companies. However, the Companies also agreed, in the alternative and if the Commission rejects one or more of these three riders as being too administratively complex and burdensome, that tracking the underlying revenues and costs in deferral accounts, for later refund or adjustment to base rates as determined on an annual basis, would be acceptable. Grace Reb., NS-PGL Ex. VG-2.0, 50:1094 – 51:1134; *see* Staff Init. Br. at 221. Contrary to Staff's assertions, deferrals of such revenues and costs would not violate test year principles but would, instead, allow the Companies to go forward with these expenditures and proposals that will result in undisputed customer benefits.

1. **<u>Risk of Mismatching Costs and Revenues Will Be Reduced</u>**

Rider VBA would normalize the Companies' recovery of the portions of their margin revenues that are recovered through volumetric charges Feingold Dir., PGL Ex. RAF-1.0, 11:243-246; Feingold Dir., NS Ex. RAF-1.0, 12:248 – 13:250. If a deferral mechanism were utilized in lieu of Rider VBA, it would hardly constitute a utility "overstating its revenue requirement by mismatching low revenue from one year with high expense data from a different year" as Staff alleges. Staff Init. Br. at 223, *citing Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 1058 (1991) ("*BPI II*"). Instead, the opposite would occur – revenues and costs from the same year would be matched as closely as possible by "taking gas volumes out of the ratemaking equation." Feingold Dir., PGL Ex. RAF-1.0, 26:516; Feingold Dir., NS Ex. RAF-1.0, 24:520.

The court denied recovery of deferred depreciation costs in *BPI II* because deprecation "recognizes the cost of that portion of the asset which is expended in a given year [even] though there is no cash outlay in the current year," with deferral of such expenses for future recovery violating test-year principles by artificially shortening the amortization period of the underlying capital items such that costs would be recovered over less than the useful lives of the plants. *BPI II* at 1059-1060. This mismatching concerned the court in *BPI II* because of its desire to prevent utilities from "inaccurately portray[ing] a higher need for rate increases." *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d at 139 (1995) ("*CUB*").

Such concerns are not present here with respect to Rider VBA (and the deferral requested in the alternative), which is analogous to the court's view of the cost reconciliation formula at issue in *CUB* which was "used to determine the amount of the rider charge includes a matching of costs incurred with revenue realized." *CUB*, 155 Ill 2d at 140. Under those circumstances the court in *CUB* "agree[d] with the Commission and the utilities that the test-year rule seeks to avoid a problem not present when expenses are recovered through a rider," *id.*, and the same analysis applies to a deferral mechanism if deemed less administratively burdensome and complex than Riders VBA, UBA and/or EEP. By regularly monitoring and modifying the applicable margin revenues each month to account for weather fluctuations and changes in usage patterns, a margin revenue deferral account alternative to Rider VBA would allow the Companies to most closely match the amortization periods of assets (as well as the authorized revenue requirement generally) reflected in the calculations underlying the rates established in this proceeding. This would allow the Companies to prevent, not proliferate, the mismatching or overstatement of revenues and expenses that concerned by the court in *BPI II*.

2. <u>Rider VBA Includes Type of Costs Approved For Deferral in *BPI II*</u>

The margin revenues that would be tracked in the deferral account alternative to Rider VBA would include "a fair and reasonable return on its utility assets" (Feingold Dir., PGL Ex. RAF-1.0, 15:302-303; Feingold Dir., NS Ex. RAF-1.0, 14:297-298), the very type of cost that the court in *BPI II* upheld as appropriate for deferral because:

> post-in-service financing costs compensate [the utility] for the time value of its money which is still invested in the asset. These capital costs are a function of the value of the unused portion of the asset. We believe this is the fundamental reason the costs are treated differently for ratemaking purposes.

BPI II 146 Ill. 2d at 241; Staff Init. Br. at 224. Therefore, and as the court made clear in *CUB* when it later upheld the Commission's authorization of coal tar cleanup cost deferrals, neither *BPI II* nor the proposed generic rulemaking which followed (Staff Init. Br. at 224-25) require that all deferral requests be rejected.

3. <u>The Commission Has More Flexibility Than Staff Acknowledges</u>

The court in *CUB* further recognized the Commission's "discretion in selecting the means by which rates are set and costs are recovered, and the appropriateness of the rider mechanism in certain instances," and that same discretion which support the requested riders also authorizes Commission approval of the deferral accounts requested here in the alternative. *CUB*, 166 Ill. 2d at 138 ("the Commission's power is not limited to determining a mere charge or a particular rate; rather, the Commission has the power to change, under certain conditions, any part of a filed schedule rate, rule, or regulation that in any manner affects the rates charged") (*accord City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607 (1958)).[36]

[36] S*ee also, e.g.*, *In re South Beloit Water, Gas and Elec. Co.*, ICC Docket No. 03-0676 (Cons.), p. 19 (Order Oct. 6, 2004) ("The types of rate recovery mechanisms that are designed to track and reconcile item-specific expenses and/or revenues on an ongoing basis for eventual matching and adjustment, such as riders, are alternatives to setting base rates via the test year ratemaking process, not part of it, as explained [in *CUB*]").

As more recently stated by the Commission with respect to a residential rate stabilization program proposed by ComEd, the "Court in *BPI II*, furthermore, did not seem to suggest or assume that rate moderations plans are inconsistent with principles enunciated in *BPI II*, noting: '[o]n remand the Commission will establish new rates, and presumably a new moderation and allocation plan' … The Commission finds it significant that [ComEd does not] seek approval of a regulatory asset that would be recovered in subsequent rate proceedings." *In re Commonwealth Edison Co.*, ICC Docket No. 06-0411 p. 19 (Order Dec. 20, 2006), *citing BPI II*. *See also, e.g., In re Illinois-American Water Co.*, ICC Docket No. 02-0690, p. 68 (Order Aug. 12, 2003) (deferral may be appropriate despite *BPI II*, where "deferred amounts may be used to help arrive at a more normal or representative test year allowance as an alternative to unrepresentative test year projections, but they are not used to provide a supplement or addition to a normal level of annual expenses"). These three riders, most notably Rider VBA, fall squarely within these noted "exceptions" to *BPI II* – they allow for the most accurate matching of ratemaking assumptions to weather- and usage-based realities, while preventing rather than promoting any long-term carry-over of costs to future rate case proceedings.

4. Staff Acknowledges Non-*Pro Forma* Adjustments Do Occur

If Staff's position as stated in its Initial Brief were correct, then no decoupling mechanism could be approved by this Commission because, by its nature, decoupling requires separation of the effects of changes in weather and usage from base rates. However, Staff's position that all ratemaking flexibility is lost after *BPI II* does not hold up under the above analysis, and Staff witness Ms. Hathhorn herself acknowledged as much on cross-examination in this proceeding. Ms. Hathhorn accurately acknowledged that "[t]here can be non-*pro forma* adjustments" in Illinois rate cases, that the result of normalizations resulting from such adjustments could be lower or higher than the test year values, that uncollectible expenses have been treated in this fashion, and that in approving such treatment the Commission has authorized the amortization of operating expenses. Hathhorn, Tr. at 1127:19 - 1128:18. Ms. Hathhorn also agreed that the Commission has previously allowed, under such circumstances, the inclusion of unamortized balances (including operating expenses) in rates established during subsequent rate cases, in the event that the amortization was not completed in the interim period. *Id.* at 1129:2-19.

5. <u>Deferral Alternatives For Riders UBA and EEP</u>

Staff's position regarding a deferral alternative to proposed Rider UBA (through which gas cost-related uncollectible expenses would be recovered) should similarly be rejected, for the reasons described above and, in particular, because even Ms. Hathhorn acknowledged that normalization of uncollectible expenses is hardly unprecedented in her experience. The reasons discussed earlier for Rider EEP also would justify deferral as to the energy efficiency program costs. However, the evidence is uncontradicted that, absent Rider EEP these program costs should be added to the Utilities' revenue requirements for recovery thorugh base rates. E.g., Fiorella Reb., NS-PGL Ex. SF-2.0, 15:333-16:341.

A final alternative, as suggested by GCI, is to include the fixed $7.5 million annual amount across both utilities "in the basic revenue requirement in these consolidated dockets" in order to ensure this defined level of funding is available (Brosch Dir., GCI Ex. 1.0, 72:4-9; AG Init. Br. at 113; ELPC Init. Br. at 2, 10-11), with "a deferral accounting mechanism should be employed to track and reconcile differences between recovery (through base rates) and disbursements made by each utility for conservation prograMs. Then, in future rate case proceedings, any unspent balance in the deferral account could be evaluated and recognized in the establishment of a revised ongoing level with new base rates." Brosch Dir., GCI Ex. 1.0, 72:19 - 73:3; Grace Reb., NS-PGL Ex. VG-2.0, 51:1123-1134; City-CUB Init. Br. at 84, 90.

Without one of these multiple options, the energy efficiency proposal contemplated in Order Point No. 27, and supported by parties to this proceeding as well as providing one basis for this Commission's approval of the reorganization, will be jettisoned in its entirety.

VIII. COST OF SERVICE

A. Overview

The Utilities have filed to allocate common system distribution costs utilizing the Coincident Peak ("CP") method and other parties advocate the use of the Average and Peak ("A&P") method. The Utilities continue to believe the CP method best reflects cost causation on the system. It appears that the Utilities' and Staff's initial difference of opinion regarding Account No. 904 costs may be moot. GCI continues to oppose the proposal to bifurcate Service Classification ("S.C.") No. 1 into S.C. Nos. 1N and 1H and to insist upon directly assigning Account No. 385 costs. The Utilities continue to take issue with the suggestion that differentiated class rates of return are reasonable and that Peoples Gas' use of the EPEC methodology is not appropriate.

B. Embedded Costs of Service Study

1. Uncontested Issues

Please see NS-PGL Init. Br. at 142.

2. Contested Issues

a. Coincident Peak Versus Average and Peak Allocation Methods

While the Companies have proposed that the CP method of cost allocation be applied, Staff, AG and City-CUB oppose utilization of the CP method and recommend that an Average and Peak ("AP") method be used instead. Essentially, the parties criticized the CP method because they believe that the CP method incorrectly assumes that system costs are driven by peak demands on the system. Those parties believe that a "significant amount" of distribution costs are not affected by peak demand considerations. Staff Init. Br. at 228. Staff witness Mr. Luth bases his recommendation of the A&P method upon his belief that distribution costs are affected by, but not entirely dependent on peak demand and that some consideration be given to average deliveries. Staff Ex. 7.0, 13:246-255.

The Utilities believe that the CP method is the soundest approach to allocation of system costs. The CP method most closely matches the principle that cost causation should follow cost responsibility. The distribution system was built to serve the peak demands of the system. Thus, a customer's peak demand on the system corresponds to the costs that have been incurred to install that capacity. Since the customer's demand on the system prompted the installation of facilities to meet that demand, it stands to reason that customers should be allocated costs in a manner that recognizes their call on the system.

The CP allocation method requires each customer to pay for the capacity that it is entitled to call upon whenever its usage necessitates it, whether on one day a year or every day of the year. To recognize average usage, as does the A&P method, is to incorporate non-cost considerations into the allocation process. This results in diminishing cost causation responsibility and transferring cost responsibility from those customers who cause it to those customers who really bear less responsibility for the costs having been incurred.

While the Staff asserts that the Commission has "consistently" found the A&P method preferable to the CP method, this is misleading. The Commission has indeed approved the CP method in the Utilities' last two rate cases, *In re Peoples Gas Light and Coke Co.*, ICC Docket

Nos. 91-0007 and 91-0586; in the two Peoples Gas rate cases prior to those, the A&P method was adopted.[37] There is thus no settled practice in regards to the method for allocation of system costs. The trend toward promoting more direct responsibility for costs and the imperative of moving customers toward full cost responsibility as followed in the Utilities, rate design proposals, require that the same concept be applied in the system cost allocation process. The Utilities therefore urge the Commission to apply the CP method of cost allocation to the system costs in these proceedings. Contrary to the assertion by AG that the A&P method establishes "clear precedent" (AG Init. Br. at 136), the Commission has also shown a preference for the CP method and the Utilities believe that adoption of the CP method would be more consistent with the ratemaking policies employed most contemporaneously.

b. Classification of Uncollectible Account Expenses Account No. 904

Only Mr. Luth on behalf of Staff took issue with the Utilities' classification of Account No. 904 costs. The Utilities set forth their position on the issue in their Initial Brief. NS-PGL Init. Br. at 144-145. Staff did not address the matter in its Initial Brief and neither did any other party. The Utilities maintain the position set forth in their Initial Brief.

c. Allocation of Costs to S.C. No. 1H and S.C. No. 1N

As was indicated in the Utilities' Initial Brief, only GCI flatly opposes the bifurcation proposal. In their Initial Brief, the Utilities set forth why the bifurcation proposal is reasonable and appropriate. NS-PGL Init. Br. at 145-149. In its Initial Brief, GCI argues that the bifurcation results in higher rates for heating customers with less flexibility in the winter and creates a subsidy of non-heating customers by heating customers. GCI's arguments are

[37] ICCDocket Nos. 90-0007 and 91-0586. In fact, the Commission Staff, which now supports the A&P method, submitted testimony in support of the CP method in ICC Docket No. 91-0586.

misplaced. As the Utilities' established, the purpose of bifurcation is to allow better alignment of costs and revenue recovery and to promote more equity between and within rate classes by setting rates closer to the costs of service. The Utilities have demonstrated that the fixed costs for heating customers are twice as high as those of non-heating customers and that such a significant difference would result in recovery of fixed costs through fixed charges under a single rate which could overburden small non-heating customers.

GCI does not appear to actually have offered a persuasive reason why bifurcation is inappropriate in view of the Utilities' reasoning. GCI simply complains that the resulting rates are higher in outcome, a phenomenon which necessarily attends a rate increase proposal. In addition, GCI makes a vague argument that somehow the heating versus non-heating distinction obscures a single family versus multi-family distinction. The latter distinction is not supported by the evidence of record. In fact, Mr. Glahn appears to concede that the distinction is moot when he states that "The cost – causation information in this observation regarding multiple units is largely lost in the Companies' artificial distinction between "heating" and "non-heating". Glahn Reb., GCI Ex. 6.0 REV; 4:82-88. If Mr. Glahn is concerned with preservation of the single family versus multiple family distinction, he need not worry or disturb the Utilities' bifurcation proposal, because as Mr. Amen points out, the costs – causation feature of service lines is not lost because it is directly allocated to each rate class. Amen. Sur., NS-PGL Ex. RJA-3.0, 9:185-195.

d. <u>Allocation of Distribution Plant Account No. 385</u>

In their Initial Brief, the Utilities set forth all the arguments why Mr. Glahn's proposal to directly assign Account No. 385 costs directly to customers is unreasonable and unjustified. GCI raised no new arguments respecting Account No. 385 and the Utilities remain persuaded that their reasoning is sound.

Similarly, the AG offers little new in the way of argument from Mr. Glahn's proposal. The AG makes the assertion that there is an "overriding preference" for direct assignment of costs. The AG points to no authority for that proposition because there is none in the context of the ECOSS studies presented in these proceedings. The parties proposing direct assignment of Account No. 385 costs are singling out particular costs and declaring that they should not be allocated to the class simply because they are identifiable to a specific customer. As Mr. Amen has pointed out, there are many costs that could be so identified and to begin with Account No. 385 costs could open the floodgates for broader direct assignment. Amen Sur., PGL-NS Ex. RJA-3.0; 10:210-235. This can only lead to fractured and unnecessarily numerous rates and charges for the Utilities.

e. <u>Differentiated Class Rates of Return</u>

Only City–CUB raised the issue of differentiated rates of return. City–CUB criticizes the Utilities' ECOSS because it utilizes equalized class rates of return of 8.25% and 8.57% for Peoples Gas and North Shore, respectively. Amen Dir., PGL Ex. RJA-1.0, 2:28-31; Amen Dir., NS Ex. RJA-1.0, 2:27-30. Although the AG urges that the Companies did not meet their burden of proof on this issue, the AG is wrong. The Companies' burden of proof centers around whether they have properly identified the cost responsibility of the customer classes on an equal footing at the system average or "equalized" rates of return, which provides the correct starting point for determining an appropriate level of class revenue responsibility. The Companies have done so and the Commission should disregard the AG's burden of proof remark. More importantly, the AG admits that it has raised the differentiated class rate of return issue simply to cast some doubt on the results of an ECOSS. See NS-PGL Init. Br. at 151. Such reasoning is frivolous and should be disregarded.

f. <u>Allocation of Revenue Requirement to Customer Classes</u>

Mr. Glahn has taken issue with Peoples Gas' application of the EPEC methodology for allocating the revenue requirement to Peoples Gas' S.C. Nos. 1N, 1H and 2. Mr. Glahn's sole basis for criticizing Peoples Gas' EPEC method is that he believes that it applies arbitrary customer class groupings. Glahn Dir., GCI Ex. 3.0 REV, 12:6-13:23 Mr. Glahn never explains why he believes that the customer class groupings under the EPEC method are arbitrary. Rather, he simply recites the revenue cost ratio effect of the EPEC method and proceeds to inappropriately allocate additional costs to one service classification (S.C. No. 4), which is set at cost, and to another service classification, (S.C. No.7), where contractually set rates already reflects the appropriate cost considerations.

Mr. Glahn ignores the purpose of the groupings, which are simply to employ the EPEC methodology for S.C. Nos. 1N, 1H and 2, which has been approved by the Commission in Peoples Gas' last two rate proceedings, and to set S.C. No. 4, which combines two similar service classifications, at cost. [38]

Ms. Grace explains in detail why S.C. No. 4 should be set at cost and why Mr. Glahn's proposal for S.C. No. 7 is not appropriate. Finally, Mr. Glahn's methodology is mathematically incorrect and results in an increase which is $533,971.00 higher than what has been proposed by Peoples Gas. *See* Ex. VG-2.2, pg. 1, columns A and D and GCI Ex. 3.0, Ex. WLG-D, Schedule 2, column (4). Both Peoples Gas and Staff support setting S.C. No. 4 at cost. Mr. Glahn is the

---

[38] Mr. Glahn argues Peoples Gas' proposal violates the principle of horizontal equity. Glahn Dir., GCI Ex. 3.0, 12:21-23. There is no horizontal equity among the classifications involved and Mr. Glahn has not provided any evidence that horizontal equity should apply.

only witness that supports setting S.C. No. 4 over cost or allocating costs to S.C. No. 7. In addition to his proposals being unreasonable for the reasons previously discussed, Mr. Glahn's S.C. Nos. 4 and 7 proposals are more problematic because although he inappropriately allocates additional costs to these service classifications, he made no specific rate design proposals for either one. For all other reasons discussed herein and in the Utilities' Initial Brief, Mr. Glahn's proposals should be rejected.

IX. <u>RATE DESIGN</u>

A. <u>Overview</u>

Ultimately, rate design is an exercise in judgment and the Utilities believe that their proposals represent the most even handed and comprehensive exercise of judgment resulting in rates that are just and reasonable for the entire system. In contrast, City-CUB and the AG, have demonstrated an extreme bias toward protecting residential and low income customers with a narrow focus on one part of the Utilities' full rate design for small residential customers. Ms. Grace, on the other hand, has sought to design rates that do not favor any particular customer group and that simply follow conventional principles and a method of gradualism that has been employed for some time and approved by the Commission in prior cases. For these reasons, the Commission should accept the rate design proposed by the Utilities and reject those of Mr. Glahn.

B. <u>General Rate Design</u>

1. <u>Allocation of Rate Increase</u>

See Section VII(B)(2)(f), *supra.*

2. <u>Gas Cost Related Uncollectible Expense</u>

Only the Utilities and Staff have joined the issue of the appropriate recovery of gas cost related uncollectible expense for retail sales and transportation customers. The issue is only relevant if the Commission does not approve Rider UBA. In such an event, since transportation customers do not ordinarily purchase gas from the Utilities, the gas cost related portion of uncollectible expense must be appropriately removed from the base rates.

The Utilities propose to develop base rates for all customers, which would exclude the gas cost portion of uncollectible expense. The Utilities would then incorporate the gas cost portion of uncollectible expense back into rates for sales customers. The gas cost portion of uncollectible expense would be based on test year gas costs. On the other hand, Mr. Luth would develop base rates for all customers, which includes the gas cost portion of uncollectible expense, and factor in a credit for transportation customers with an offsetting charge for retail sales customers. Staff Init. Br. at 231-233. Mr. Luth would also base his credit and offsetting charge on present rate gas costs rather than those that are reflected for the test year. *Id.*

Although the Utilities have demonstrated that such costs are customer related, both Mr. Luth and Ms. Grace would recover uncollectible expenses in the distribution rates. The Utilities believe that their method is simpler than that proposed by Mr. Luth. However, the Utilities would find Mr. Luth's methodology acceptable, if corrected to reflect test year gas costs and the appropriate revenues to be used in the determination of the credit for transportation customers' base rates.

C. <u>Service Classification Rate Design</u>

1. <u>Uncontested Issues</u>

Please see NS-PGL Init. Br. at 164-165.

2. <u>Contested Issues</u>

a. <u>Peoples Gas Service Classification Nos. 1N and 1H</u>

The issue pertaining to whether the Utilities' currently applicable S.C. No. 1 should be bifurcated into separate classifications for heating (S.C. No. 1H) and non-heating (S.C. No. 1N) is joined by AG and the Staff. The AG (Init. Br. at 136-141) argues that the bifurcation has not been justified and should be rejected, while Staff (Init. Br. at 234-239) urges that if the bifurcation is approved, certain other procedures must accompany it. Those procedures involve permitting customers to annually elect the classification under which to receive service. On the other hand, the Utilities' bifurcation proposal is based upon the significant cost differential between small residential heating (S.C. No. 1H) and non-heating (S.C. No. 1N) customer classifications and the appropriate designation of accounts based upon utility information, practices and analyses. NS-PGL Init. Br. at 165-169.

The Staff does not oppose bifurcation *per se*, but would base it upon volume, *i.e.*, high usage versus low usage, instead of the Utilities' heating versus non-heating distinction. Staff would apply its annual customer election features in any case. The Utilities have demonstrated that their proposed bifurcation proposals are warranted based on the cost differentials between S.C. No. 1H and S.C. No. 1N and have shown that customer accounts are properly designated[39]. The Utilities have also explained in great detail why Mr. Luth's "customer election" proposal is not workable and crushingly problematic.

Staff has indicated, however, that if its proposed annual customer election feature is considered to be administratively challenging or burdensome, that the Utilities should consider developing rates for a non-bifurcated service classification which would collapse proposed S.C. No. 1N and 1H into a single S.C. No. 1. Staff also indicated that it would also find acceptable a customer charge developed by Ms. Grace at the Utility's proposed revenue requirement with

[39] Mr. Luth acknowledges the differences in cost with similar costs differences reflected in his own cost study.

Rider UBA if the Commission does not approve Rider UBA. *See* Staff Init. Br. at 236. Staff implicitly agrees with the Utilities' approach to developing a S.C. No. 1 customer charge if the Utility's bifurcation proposal is not approved. However, Staff proposes that a lower customer charge be based on a revenue requirement with Rider UBA, even if Rider UBA is not approved. This is illogical and inconsistent. It would be more logical and more consistent that the Commission accepts a customer charge that is aligned with the approved revenue requirement. Therefore, the customer charge should be based on the revenue requirement without Rider UBA, if Rider UBA is not approved, and with Rider UBA, if Rider UBA is approved. If the Commission must choose between the Utilities' bifurcation proposals and Mr. Luth's "customer election" proposals, which would adversely impact the Utilities as well as customers, the Utilities would prefer a customer charge using its proposed approach. *See*, Grace Sur., NS-PGL Ex. VG-3.0; 16:339-343.[40]

The Utilities maintain their position that their proposed bifurcation for S.C. No. 1H and S.C. No. 1N is justifiable and should be approved and not complicated by the Staff's convoluted and overwhelmingly problematic annual election proposal. No such enhancement is necessary because it would impose a level of complexity and confusion into the process that is not warranted. The Utilities have demonstrated and no party has seriously rebutted that they maintain reliable and fairly comprehensive data to justify bifurcation along heating and non-heating lines. The Utilities also conducted a cost study analysis to demonstrate that heating customers create significantly higher system costs than non-heating customers. While Mr. Luth made a vague reference to a volume based bifurcation model, he offered no reasoning or data to

[40] Assuming the Utilities' proposed revenue requirements, Peoples Gas' S.C. No. 1 customer charge would be $15.79 with Rider UBA and $16.90 without Rider UBA. North Shore's S.C. No. 1 customer charge would be $14.69 with Rider UBA and $15.04 without Rider UBA. Grace Sur., NS-PGL Ex. VG-3.0, 11:245-12:247.

support why volume should be the basis for bifurcation. Mr. Luth's election proposal should therefore be rejected. If the Commission must choose between the Utilities' bifurcation proposals and Mr. Luth's "customer election" proposals, which have been demonstrated to be highly problematic for the Utilities as well as customers, the Utilities would prefer a customer charge using their proposed approach.

The Utilities have demonstrated that their proposed bifurcation proposals are warranted based on the cost differentials between S.C. No. 1H and S.C. No.1N and have shown that customer accounts are properly designated[41]. The Utilities have also explained in great detail why Mr. Luth's "customer election" proposal is not workable and crushingly problematic.

In its opposition to the Utilities' bifurcation proposal, the AG makes a series of unconnected and partially applicable claims. For example, the AG asserts that an increase of 100% "in a rate element" - - i.e., in any <u>part</u> of a bill such as a single charge -- constitutes rate shock. AG Init. Br. at 137. AG's argument is exaggerated since it only focuses on the Utilities' proposed customer charges for S.C. No. 1H and completely ignores the offsetting decreases in the proposed distribution charges.

The AG attempts to couch its criticism in theoretical constructs. AG urges that the Utilities' increases "fall disproportionately on those least able to pay", thereby failing a purported, "social goals test". *Id.* The fact is that any rate increase of any kind affects those with less ability to pay, but the AG has made absolutely no showing to support its claim of "disproportionality". Furthermore, following the AG's line of reasoning, any rate increase would fail its "social goals test", a test which has no legal force but is merely one principle, among many, some contradictory and inconsistent, which are posited by a theoretician, Dr.

[41] Mr. Luth acknowledges the differences in cost, with similar costs differences reflected in his own cost study.

Bonbright. On the other hand, Peoples Gas has proven that low-income customers tend to consume gas at levels higher than the class average and that its proposed rate design would be more favorable to such customers than the lower customer charge, higher distribution charge rate design that would arise from Mr. Glahn's proposal. Similarly, North Shore's rate design would be favorable for low-income customers during the winter period when gas prices are typically higher. *See* Grace Reb., NS-PGL Ex. VG-2.0, 37:807-39:857 and 43:910-942.

The AG also cites a "conservation of resources" test and an "environmental test" that it claims are failed because lowering distribution charges discourages conservation and causes negative environmental impacts. AG Init. Br. at 137-138. The Utilities have shown that gas costs, which are the most significant portion of a customer's bill, provide the appropriate test. *See* Grace Reb., NS-PGL Ex. VG-2.0, 29:858-866.

Suffice it to say that the AG's reference to theories and purported tests is highly selective and is intended create the impression that its favored goals are paramount in rate design. Obviously, a reasonable rate design must incorporate goals that are considerably more even handed and broadly applicable.

As Ms. Grace has pointed out, the Utilities have proposed rates and rated designs that incorporate many of the theoretical principles, including social goals, that typically apply in rate design. She also notes that there is no requirement that rate designs must meet all theoretical rate design objectives or that such a feat is even possible. Even Mr. Glahn acknowledges that there are often conflicts among rate design objectives. The Utilities have sought to employ sound rate design principles and other measures that they believe are most appropriate and reflect their interests of all customers and customer groups. No amount of shrill and misleading assertions should be allowed to obscure this even handed and reasonable approach of the Utilities. Hence, the Commission must disregard false and irresponsible assertions such as the the AG's suggestion that the Utilities have "fudged their cost apportionments by using the category of customer costs as a dumping ground for costs that they cannot plausibly impute to any other costs categories." AG Int. Br. at 149. No such allegation or implication can be found on the record or otherwise regarding the Utilities' rate design proposals.[42]

That the AG's intent is to preserve an unwarranted rate design advantage for residential customers is apparent from Mr. Glahn's proposal to set the monthly customer charges for Peoples Gas at $10.50 and $8.50 for North Shore. Mr. Glahn proposes these customer charges in an almost casual manner. He offers absolutely no cost analysis or justification to support them, aside from broad references to customer charges of other Illinois utilities, never analyzing or explaining how their costs structures require that their resulting rates should in any way apply to the Utilities. In short, Mr. Glahn's customer charge proposals are superficial, not well reasoned and completely unsupported by any cost or rate analysis. They appear to be purely outcome driven. This Commission of course should never endorse such a careless and parochial approach to designing customer charges and the proposals of the AG must be denied.

City-CUB engages in similar end-results oriented pleading to advocate unreasonably low customer charges. City-CUB makes several of the same claims as AG that despite all clear reasoning to the contrary, lower customer charges must be preserved to protect the interests of one group of customers – low and fixed income rate payers.[43] In the final analysis, City-CUB

[42] Again, rather than burdening the Commission with a motion to strike, the Utilities simply request that this inflammatory suggestion be totally disregarded.

[43] City-CUB essentially admits that even if the impact of higher customer charges is mitigated by lower distribution charges, this is irrelevant to its quest to assure that low and fixed income customers do not fairly shoulder the appropriate cost responsibility. *See* City-CUB Init. Br. at 113-114

has offered no more persuasive reasoning in support of Mr. Glahn's proposals and they must still be rejected.[44]

Only the Utilities have presented proposals for S.C. No. 1N and S.C. No. 1H rates that are comprehensive, detailed and analytical. The rate proposals of Mr. Glahn are very general and superficial and not based on any cost studies or reasoned analysis. On the other hand, Mr. Luth proposes very reasonable customer charges for Peoples and North Shore S.C. Nos. 1N and 1H. He also reasonably recommends that Peoples Gas' S.C. No. 1N distribution charges be reduced to offset the increase in the customer charge. He makes no recommendation as to distribution rates for North Shore and Peoples Gas' S.C. No. 1N. Mr. Luth proposes to reduce the distribution rates for North Shore's S.C. No. 1H as his ECOSS allocates fewer costs to S.C. No. 1H than North Shore's ECOSS. This would also be reasonable. However, his proposal for Peoples Gas S.C. No. 1H distribution charge is too general to warrant any consideration. Since the customer charge proposals of the Utilities do not differ significantly from Staff witness Luth's proposals, approval of the Utilities comprehensive and well reasoned proposals for rates for S.C. No. 1N and S.C. No. 1H would amount to acceptance of a large part of the Staff proposal.

D. Tariffs – Other Tariff Issues

Overview

The Utilities propose several changes in a variety of tariffs for various reasons. None of the intervenors have opposed any of the changes to the Tariff issues delineated in this section

[44] City-CUB's arguments that Mr. Luth's customer charge proposals should be rejected are equally flawed and should be disregarded for the same reasons discussed in respect of the Utilities' proposals.

with the exception of the AG, who opposed the $25.00 NSF charge. However, Staff has objected to language in some of the Tariffs, but of which all objections have been resolved.

1. Rider 2, Factor TS

The Utilities propose to revise Rider 2 to reflect the applicability and renaming of applicable transportation riders. The Companies also propose to eliminate Factor TS, Transition Surcharge and refund or recover any dollars awaiting recovery or refund through Factor NCGC, Non-Commodity Gas Charge. Staff witnesses Daniel Kahle and Cheri Harden support the Companies' proposal to roll Factor TS balances into their non-commodity gas charges. Harden Dir., Staff Ex. 9.0, 24:516-518; Harden Reb., Staff Ex. No. 21.0, 2:23-3:27. Given that no other parties have addressed this matter, the Companies' proposal is uncontested.

2. Charge for Dishonored Checks and/or Incomplete Electronic Withdrawal

The Companies propose to increase their charge for dishonored checks and incomplete electronic withdrawals from $10.00 to $25.00 to better reflect prevailing rates for such checks and transactions and to discourage customers from making deficient payments to the Company. Grace Dir., PGL Ex. VG-1.0 2REV, 32:709-711. The Commission has approved an increased charge of $25.00 for MidAmerican Energy in ICC Docket No. 99-0534. *Id.* at 32:716-717. The *MidAmerican* Order stated that the increase "would serve to discourage payment with checks that are not valid" and that revenues from this charge will serve to reduce the rates of those customers who make valid payments. *MidAmerican*, ICC Docket No. 99-0534, 2000 Ill. PUC LEXIS 563 at 34, (Order, July 11, 2000). In these proceedings, as in *MidAmerican Energy*, revenue from the Utilities' charge will offset the increase in base rates in this proceeding. Grace Dir., PGL Ex. VG-1.0 2REV, 32:711-718. Staff witness Ms. Harden is supportive of the Companies' proposal. Harden Dir., Staff Ex. 9.0, 11:226. GIC witness Mr. Glahn opposes the increase in the charge for dishonored checks and incomplete electronic withdrawals, basing his opposition on a lack of a cost study. Glahn, Reb., GCI Ex. 6.0 REV, 15:354-362; Glahn Dir., GCI Ex. 3.0 REV, 35:2-16. The Commission was clear when it approved a similar increase in the *MidAmerican* Order (ICC Docket No. 99-0534) to better reflect prevailing rates and to discourage customers from making deficient payments to the company. As Staff agrees, the Commission should approve the increase for dishonored checks and incomplete electronic withdrawals.

3. Rider 4, Extension of Mains

The Utilities propose changes to Rider 4 to clarify language and to address certain practices and customer preferences. The basic structure of Rider 4 is unchanged. The Companies are responsible for the costs associated with certain main installations as Part 500 of Commission's Rules provides. However, when, for example, a customer requests that the Companies install a main in a different location than is required to provide service, the customer would bear the incremental costs associated with meeting the customer's preferences. Grace Dir., PGL, Ex. VG-1.0 2REV, 36:795-802. Staff witness Ms. Harden disagreed with the language of Rider 4 regarding "return" and testified that the proposed language should not be approved for Rider 4. Harden Reb., Staff Ex. 21.0, 4:92-5:98. The Utilities have agreed to concede to the objection of Staff Witness Harden and remove the proposed language regarding "return". Grace Sur., NS-PGL Ex. VG-3.0 REV, 29:627-628. No other parties addressed this matter and therefore, this matter is not contested.

4. Rider 5, Gas Service Pipe

The Utilities also propose to revise Rider 5 to clarify language and to address certain practices and customer preferences. The Utilities proposed to reduce the free main extension shown in Rider 5 from 100 feet to 60 feet consistent with an agreement between Staff and parties related to question raised by the Commission when it initiated Docket No. 03-0767. Grace Dir., PGL Ex. VG-1.0 2REV, 36:804-37:811. As with Rider 4, Staff witness Ms. Harden disagreed with the language of Rider 5 regarding "return" and recommended the language not be approved by the Commission. Harden Reb., Staff Ex. 21.0, 6:133-135. As with Rider 4, the Utilities agreed to concede to the objection of Staff Witness Harden and remove the proposed language regarding "return". Grace Sur., NS-PGL Ex. VG-3.0REV, 29:627-628. No other parties addressed this matter and therefore, it is not contested.

5. <u>Rider 8, Heating Value of Gas Supplied</u>

The Companies propose to revise Rider 8 to reflect the applicability of the rider based on the elimination and renaming of transportation riders and to make a minor grammatical change. The revisions also specify that the Utilities will make filings only when the heating value factor changes, rather than file every month. Grace Dir., PGL Ex. VG-1.0 2REV, 37:821-824. Staff witness Ms. Harden opposes the Utilities' change regarding monthly filing requirement believing there would be no assurance that the Utilities are reviewing heating value factors. Harden Reb., Staff Ex. 21.0, 8:175-179. The Utilities review heating values on an ongoing basis in the due course of their business, not simply on a monthly basis. The heating value factor often remains the same for two or more consecutive months, and a filing is only needed when the factor changes. Grace Dir., PGL Ex. VG-1.0 2REV, 37:821-826. Therefore, it is appropriate that filings be made only when there is such a change.

6. <u>Elimination of Riders 13, 14, 15, CCA and LCP</u>.

Staff witness Ms. Harden agrees with the Companies proposed elimination of Riders 13, 14, 15, CCIA and LCP. Harden Dir., Staff Ex. 9.0, 18:392-397, 19:409-415, 19:425-426, 20:445, 21:461. No other parties addressed these matters, which leaves them uncontested.

7. Miscellaneous Changes to Riders 1, 3, 10 and 11

a. Rider 1, Additional Charges for Taxes and Customer Charge Adjustments

See NS-PGL Init. Br. at6 180.

X. TRANSPORTATION ISSUES

A. Overview

Section X(A) of the Utilities' Initial Brief in these proceedings contains a comprehensive overview of the transportation issues. NS-PGL Init. Br. at 188-191.

B. Uncontested Issues

The Utilities set forth ten uncontested issues in Section X.(B) of their Initial Brief. These ten issues are: (1) Demand Diversity Factor, (2) Daily Demand Measurement Device Charge; (3) Elimination of Rider TB on North Shore; (4) Revised Calculation of Average Monthly Index Price; (5) Administrative Charges for Rider SST and Rider P; (6) Elimination of 120 Day Meter Read Requirement for CFY Enrollment; (7) Meter Reading; (8) Automatic Meter Reading; (9) Billing Demand Determination; and (10) Imbalance Trading. The Utilities' review of the Initial Briefs filed by all of the parties in this proceeding indicates that all of these issues remain uncontested in nature, and the Commission should dispose of each of them in the manner proposed by the Utilities in their Initial Brief.

C. Large Volume Transportation Program

1. Rider FST

The Utilities' original proposals to revise their large volume transportation programs were met with substantial opposition by the large volume transporters IIEC, CNEG, VES and Multiut, with Staff objecting to some, but not all, of the Utilities' proposals. NS-PGL Init. Br. at 197. In response to that opposition, and after considering the merits of the opposition's arguments, the Utilities revised their original proposals with a view toward reaching a compromise that could be accepted by all parties. *Id.* at 197.

The opponents of the Utilities' large volume transportation program proposals complain about three aspects of the Utilities' revised proposal: (1) each Utility's proposed end of season storage inventory requirements, for both FST and SST customers; (2) the capping of an FST customer's daily nominations; and (3) the capping of an SST customer's monthly injections to 20% of its AB converted to a daily limit, with no limit on a customer's withdrawal from AB. Each aspect is designed to more closely match the rights of the Utilities' transportation customers with the rights the Utilities themselves have in connection with their storage assets. NS-PGL Init. Br. at 92.

Staff would accept each Utility's proposed end of season inventory requirements and the year-around capping of each Utility's FST customer's daily nominations as a reasonable compromise between the desire for flexibility on the supplier's part and the Utilities' ability to balance their systems at reasonable cost. Staff Init. Br. at 249-253. Staff states that it opposes the Utilities' proposals regarding Rider SST. Staff Init. Br. at 250-251. However, in its discussion, Staff mistakenly refers to the Utilities' "proposed monthly limits on storage injections and withdrawals "that was a part of the Utilities' initial proposals to revise Rider SST." The Utilities' revised proposals regarding Rider SST no longer seek to impose these restrictions on Rider SST customers. The Utilities' revised Rider SST proposals incorporate similar injection limitations as proposed in the form of nomination limits for Rider FST that are acceptable to Staff. NS-PGL Ex. TZ-3.0 REV, 9:182-198; NS-PGL Ex. TZ-3.3 REV. Based on Staff's acceptance of the Utilities' proposed Rider FST, the Utilities revised proposed Rider SST also should be acceptable to Staff.

CNEG would accept the capping of an FST customer's daily nominations throughout the entire year, and it would accept a revision of the Utilities' revised SST proposal by replacing the Utilities' proposed daily injection limits with the same capping of daily nominations throughout the entire year as that proposed by the Utilities for Rider FST customers, though it continues to oppose the Utilities' storage cycling requirements. CNEG Init. Br. at 7-8. Vanguard also would accept the capping of an FST customer's daily nomination, but only during the months of April through October, and it would accept a similar capping of daily nominations for SST customers. VES Init. Br. at 3-4. Curiously, however, Vanguard opposes the capping of daily nominations from November through March even though it recognizes that the Utilities' own injection rights are more limited during this timeframe. *Id*.

A general refrain from the opponents of the Utilities' revised proposals is that the Utilities have not sufficiently demonstrated that changing various aspects of their large volume transportation programs is reasonable. CNEG Init. Br. at 11, *et. seq*., IIEC Init. Br. at 5-6. Even Staff accepts the opponents' arguments to some extent. Staff Init. Br. at 253.

Those arguments ignore, however, that the Utilities have submitted persuasive evidence that they must operate their systems as a whole, and cannot be placed in a position where system needs require action in a certain direction and transporters (who account for 35-40% of the throughput on their systems), are taking action in the opposite direction. To the Utilities the situation is analogous to a swimmer. The swimmer is trying to swim to shore, but another swimmer grabs his leg. The second swimmer tells the first swimmer: "Don't worry. You're strong enough to swim to shore even though I'm holding you back some. You've always been able to swim to shore in the past." Well, the Utilities are still worried. If the second swimmer wants to stay out in the ocean, or to swim out further, he is free to do so, but he should not be free to prevent the first swimmer from swimming to the safety of the shore.[45]

The Commission should accept all aspects of the Utilities' revised proposals for their large volume transportation programs.[46] Staff, CNEG, and Vanguard all recognize that the Utilities have a valid basis for their proposals to revise their large volume transportation programs. The Utilities have modified their proposals substantially from those which they originally filed in these proceedings. The Utilities agree with Staff that their revised proposals reflect a reasonable compromise between the differing interests of the Utilities and the suppliers.

2. Rider SST

Please see discussion under X(D)(1), above.

3. Daily Metering Requirements

Only Staff commented on this issue in its Initial Brief, and its position is that the Utilities should be able to keep the demand meter requirement for Rider SST because they have agreed to

[45] IIEC argues that limitations on withdrawals are not necessary outside of the months of December, January and February because these other months are months during which the Utilities are injecting gas, and withdrawals by transportation customers would be synergistic with the Utilities' activities and beneficial to sales customers. IIEC Init. Br. at 9. While the Utilities would concede that this might be true from a purely financial standpoint under certain (but by no means under all) circumstances, it is not true from an operational standpoint.

[46] Vanguard claims that the Utilities appear to be proposing balancing limits to generate more revenue through a daily imbalance penalty and possibly an end of month imbalance trade charge. Vanguard Init. Br. at 6. There is absolutely no support in the record for this assertion, and the Utilities dispute it. Also, as the Commission is aware, any imbalance charges would flow to the benefit of the Utilities' customers through the Gas Charge. 83 *Ill. Admin. Code* Sections 525.40(e) and (f). The Utilities themselves would not benefit financially from these daily imbalance penalty charges.

offer an alternative Rider FST without a demand meter requirement. Staff Init. Br. at 252. This comports with the Utilities' position. NS-PGL Init. Br. at 100-101. This is a moot issue.

4. Injection, Withdrawal and Cycling Requirements

As discussed in Section X(D)(1), above, a number of parties oppose the Utilities' proposed injection/withdrawal and cycling requirements. CNEG claims that the Utilities should have common cycling targets if the Commission finds that some level of cycling requirements is just and reasonable. CNEG Init. Br. at 8. However, that claim ignores the fact that Peoples Gas and North Shore are separate utilities, with separate distribution systems, assets and discrete storage rights. While it might be more convenient for CNEG if the two utilities were operated as if they were one, the fact is that they are two separate utilities, with separate tariffs, separate rate bases and cost structures. The Utilities' current and proposed transportation riders reflect these distinctions where appropriate. For example, the proposed demand diversity factors, many of the current and proposed changes and the number of days of Allowable Bank are unique to each Utility. The proposed demand diversity factor for Peoples Gas is 0.87 (Zack Dir., PGL Ex. TZ-2REV, 22:506-507), while for North Shore the proposed demand diversity factor is 0.75 (Zack Dir., NS Ex. TZ-1.0REV, 20:461-462). Based on the data available when the Utilities filed their direct testimony, the proposed number of days of Allowable Bank is 29 for Peoples Gas (Zack Dir., PGL Ex. TZ-1.0 2REV, 40:905-907), while for North Shore the proposed number of days of Allowable Bank is 26 (Zack Dir., NS Ex. TZ-1.0REV, 38:875-877), and the Gas Charge component is revised each year to reflect each Utility's supply portfolio.

CNEG also argues that the Commission imposed only a fall storage injection target on Nicor Gas transportation customers in Nicor Gas' recent rate case, and that the Commission declined to impose a spring withdrawal target on those customers. CNEG Init. Br. at 8. The outcome regarding Nicor Gas should not be applied to the Utilities because the operational facts on the Utilities' systems are distinguishable from those on Nicor Gas. The reason the Commission did not impose a spring withdrawal target on Nicor Gas' transportation customers is that Nicor Gas itself did not routinely operate its system in accordance with the same spring withdrawal targets which it was trying to apply to its transportation customers. *In re Northern Illinois Gas Company*, *d/b/a Nicor Gas Company,* Docket No. 04-0779 p. 146, (Order September 20, 2005 ("*Nicor Gas*"). Here, the Utilities have presented six years of operating data to support their proposed cycling requirements, and the data show that their proposed cycling requirements are more favorable to the Utilities' transportation customers than those within which the Utilities have been required to operate their systems over the past six years. NS Ex. TZ-1.1; PGL Ex. TZ-1.1.

CNEG claims that the Utilities have been able to properly cycle their storage gas in the past without any maximum or minimum storage level requirements imposed on transportation customers. CNEG Init. Br. at 16. IIEC makes a similar claim. IIEC Init. Br. at 11. However, part of the reason that the Utilities have been able to do so is that from time to time they have imposed delivery restrictions to which Multiut and CNEG object. Multiut Init. Br. at 7. CNEG Init. Br. at 37-39. Implementation of the Utilities' cycling requirements and the Utilities' maximum daily nomination limits should operate to reduce the Utilities' need to impose delivery restrictions.

CNEG also argues that, if the Commission accepts the Utilities' proposed cycling requirements for transportation customers, it should permit compliance with the target levels to be measured over a period of time, such as 30 days. CNEG Init. Br. at 26. The Utilities oppose this request. If the Utilities are actively shedding supplies on certain days to reach their cycling targets, they could be prevented from meeting their targets because transportation customers are adding supplies on to their systems on those same days. The converse is also true. If the Utilities are adding supplies to prepare for the winter season, the Utilities could be prevented from meeting their cycling targets because transportation customers are shedding supplies on those same days.

5. <u>Unbundled Storage Bank</u>

IIEC, CNEG and VES have advocated that the Utilities be compelled to offer transportation customers a base rate storage service that is unbundled from the AB which is supported by pipeline and company-owned service, with an unbundled storage bank ("USB") service that is supported by Manlove Field. IIEC/CNE/VES Jt. Ex. 1, 2:16-24. The proponents of USB want it because they can use it to lower their own gas costs. IIEC Init. Br. at 12-13. There is certainly nothing wrong with the goal of obtaining lower gas costs and the Utilities certainly share this goal. However, what the Utilities have a problem with is parties seeking to lower their gas costs by shifting responsibility for them to others. Therefore, the Utilities consistently have opposed the USB. Zack Reb., NS-PGL Ex. TZ-2.0, 14-23:300-508; Zack Sur., NS-PGL Ex. TZ-3.0, 21-25:449-553.

IIEC wants storage without having to acquire standby service from the Utilities, and claims that the bundling of standby service with storage is anti-competitive. IIEC Init. Br. at 12. These arguments are irrelevant. The Utilities each operate a separate utility system. Peoples Gas did not acquire Manlove Field just to provide unbundled storage service to transportation customers. It acquired Manlove Field and its leased storage services from ANR and NGPL to serve all of its customers, and all of its customers should share in its benefits as well as its costs. North Shore does not even own a storage field to support an unbundled service.

Staff also opposes the USB proposal, essentially for the reason that Manlove Field is Peoples Gas' lowest cost storage resource, and that the storage available to transportation customers should reflect the availability (and the cost) of all storage resources that the Utilities own or lease, not just the storage that has the lowest cost. ICC Staff Ex. 24.0, 13-14:255-266. Staff's Initial Brief reaffirms its opposition to USB. Staff Init. Br. at 255. For the reasons advanced by the Utilities and by Staff, the Commission should reject the USB proposal.

6. <u>Rider P-Pooling</u>

a. <u>Pool size limits</u>

As a part of their initial filings in these proceedings, each Utility voluntarily proposed to increase the maximum pool size under its Rider P from 150 accounts to 200 accounts. This is a 33% increase over the pool size limit that the Commission ordered Nicor Gas to accept in its most recent rate case. *Nicor Gas, supra*, at p. 174. The Utilities reasoned that their transportation customer suppliers would appreciate the forward-looking, voluntary concession they were making by enlarging pool sizes, but they were mistaken. Vanguard wants the pool size limit increased further, to 300 accounts. Vanguard Init. Br. at 7-8. Vanguard is seeking this even larger pool size limit on the Utilities notwithstanding the fact that Vanguard used the existence of the 150 pool size limit on Peoples Gas to argue in Nicor Gas' rate case that Nicor Gas should increase its pool size limit from 50 accounts to 150 accounts. *Nicor Gas*, at p. 174. Not to be outdone, CNEG and Staff want the pool size limit eliminated entirely. CNEG Init. Br. at 27. Staff Init. Br. at 256-257.

CNEG claims, in its Initial Brief at 28-29, that the removal of the pool size limit actually would save the Utilities time and money. Noticeably absent from this claim is any support or substantiation in the record of these proceedings. The only actual testimony concerning this issue is that of NS-PGL witness Mr.Zack, and his testimony is that the Utilities would encounter billing and other difficulties if the pool size limit were increased substantially and more so if it were to be eliminated entirely. NS-PGL Ex. TZ-2.0, 35-36:771-797; NS-PGL Ex. TZ-3.0, 18-19:393-410. CNEG also points to the fact that some Illinois gas utilities do not have any pool size limits. *Id*. Notably, Nicor Gas is not among them. In the previously discussed *Nicor Gas* case, the Commission ordered Nicor Gas to increase its pool size limit from 50 accounts to 150 accounts, so as to provide a measure of relief to suppliers while mitigating the possible impact of increased billing errors and increased administrative costs. *Id.* at 174. The Commission's reasoning in *Nicor Gas* reflects recognition that reasonable pool size limits are appropriate to accommodate legitimate Utility billing and administrative concerns. The Utilities desire the same measured and balanced approach to be applied by the Commission in these proceedings. Admittedly, Ameren CIPS and Ameren IP are Illinois gas utilities that apparently do not have any pool size limits. However, their systems are much smaller than those of the Utilities, and they only have about 200 transport customers. As a practical matter, they do not face the billing and administrative complexities faced by the Utilities, who serve thousands of transportation customers. Zack Dir., PGL Ex. TZ-1.0REV, 5:96-97; NS Ex. TZ-1.0, 5:97-98.

This Commission has never directed an Illinois utility to adopt an unlimited pool size requirement. Indeed, as noted above, the Commission has recognized that there are practical and considerable issues that arise when pool sizes become relatively larger. It is uncontroverted that the Utilities have greatly expanded pool size limitations on their systems and that the proposed pool size limits exceed those of any other Illinois utility. The Commission must not allow the shell game Vanguard appears to be employing to require even larger pool sizes by always using the last higher size to be the reference point for even larger pools.

b. <u>"Super-pooling"</u>

After initially opposing "super-pooling" the Utilities decided that they could accept it if stand-alone customers were excluded from super-pooling and if super-pooling were limited to determining compliance with end of season storage requirements. NS-PGL Init. Br. at 105. Vanguard indicated that it could accept the parameters proposed by the Utilities. Vanguard Init. Br. at 8. Similarly, Staff also would accept the parameters proposed by the Utilities. Staff Init. Br. at 258.

The sole outlier on this issue is CNEG. CNEG is not content with demanding the elimination of any pool size limit. It also wants each Utility to aggregate all supplier pools and stand-alone customers into super-pool, and it wants super-pooling also used in to the determination of unauthorized use penalties on Critical Supply Shortage Days and in the determination of Imbalance Account charges on Critical Supply Surplus Days. CNEG Init. Br. at 31. The Utilities continue to oppose CNEG' version of super-pooling.[47] The Utilities would remind the Commission that in the previously cited *Nicor Gas* case, Nicor Gas was ordered to accept super-pooling solely for the purpose of determining compliance with end of season storage cycling requirements. *Nicor Gas* at p. 149. The Utilities are willing to accept super-pooling on the same basis that Nicor Gas was ordered to accept it.

c. <u>Permitting Customers with Different Selected Standby Percentages (SSP) to Be in the Same Pool</u>.

The Utilities' Initial Brief (at 203-204) addresses this issue.

7. <u>Operational Issues</u>

[47] Curiously, CNEG (Init. Br. at 31) cites Zack Sur., NS-PGL Ex. TZ-3.0, 16:348-352 as supporting its argument that super-pooling should be applied to the application of unauthorized use penalties and Imbalance Account charges. This citation is an obvious error.

a. **Intra Day Allocations and Intra Day Nominations**

Only the Utilities and CNEG addressed the issue of intra-day nominations in their Initial Briefs. CNEG wants the Commission to compel the Utilities to accept intra-day nominations from gas transporters. CNEG Init. Br. at 34. CNEG claims that the Utilities use intra-day nominations to balance their own system supply, and that transporters should have the same rights. The Utilities agree that they use intra-day nominations to balance their own system supply – if they do not, the systems would not be balanced. CNEG attempts to frame the issue as one of discrimination, but that attempt is misplaced. On the current delivery day, only the Utilities can balance their systems and they must do so in order to protect the operational integrity of their systes. This involves making operational determinations that cannot be changed or neutralized by the actions of other parties. The Utilities cannot, for example, be in the position of shedding supply at the last minute while a supplier simultaneously is trying to increase deliveries to the Utilities. Neither can they be in the position of trying to add supply at the last minute while a supplier simultaneously is trying to shed it.

CNEG claims that a number of gas distributors, including some in Illinois, allow transporters to make intra-day nominations.[48] CNEG Init. Br. at 35. However, a number of gas distributors do not allow transporters to make intra-day nominations, so the fact that some do, and some do not, really does not prove anything. It is certainly noteworthy that the largest gas distributor in Illinois – Nicor Gas – does not allow transporters to make intra-day nominations. *Nicor Gas*, at 134-135. CNEG also argues that one of the Utilities' affiliates – Wisconsin Public

---

[48] The accuracy of CNEG' claims in this regard certainly can be questioned. In cross-examination in these proceedings, CNEG witness Mr. Oroni admitted that in his direct testimony in *Nicor Gas*, *supra*, in which the Commission declined to compel Nicor Gas to offer intraday nominations, he mistakenly testified that Peoples Gas offered intraday nominations in support of his argument there that Nicor Gas should be compelled to do so. Tr. at 776:10-22 and 777:1-21.

Service Corporation – allows transporters to make intra-day nominations. CNEG, it fails to point out, however, that Wisconsin Public Service Corporation does not provide storage or balancing services to gas transporters. NS-PGL Init. Br. at 108. Obviously, if a transporter must match its inputs and outputs precisely, it must be able to revise its nominations if it knows that actual consumption will differ from expected consumption. So, the fact that Wisconsin Public Service Corporation allows gas transporters to make intra-day nominations is of no relevance to determining whether the Utilities should be compelled to do so.

CNEG also points to other provisions in the Utilities' tariffs which it says independently control the manner and extent to which transportation customers deliver gas to the Utilities' system. CNEG Init. Br. at 36. This argument also is irrelevant. The Utilities can not in the position of scrambling to limit transporter deliveries at the last minute.

The Utilities have amply demonstrating the operational considerations that render the CNEG proposals unreasonable and CNEG has offered no evidence to counter the Utilities. The Commission must therefore reject the CNEG proposals in their entirety.

b. <u>Delivery Restrictions</u>

Multiut complains of the delivery restrictions that the Utilities have had to impose from time to time during the years 2004, 2005 and 2006. Multiut Init. Br. at 7-8. Multiut wants the Commission to prevent the Utilities from restricting customer nominations. The imposition of delivery restrictions are not a favored means of system management. Delivery restrictions are measures of last resort, but are an effective tool that the Utilities have to manage their systems. Vanguard cites the existence of this tool as one that the Utilities use to ensure that system integrity is maintained. Vanguard Init. Br. at 3. The Commission should not order the Companies to modify Rider FST Section H so as to prevent the Utilities from restricting customers from modifying their daily nominations. To do so, as Multiut suggests, would deprive the Utilities of this most reliable tool in managing their systems and could hamper the Utilities from keeping the systems operationally effective on a given day. The Utilities believe that the daily nomination and injection limits they now propose for Riders FST and SST should, if accepted by the Commission, reduce the number of times the implementation of these restrictions is necessary.

CNEG also is unhappy with these restrictions, and wants the Utilities to be directed to modify delivery restrictions on subsequent day deliveries to a level either related to prior usage or reasonably expected usage, plus a storage component, or to define a process whereby a customer could make a short term reduction in its deliveries that would not preclude an upward adjustment during an ongoing delivery restriction. CNEG Init. Br. at 38. The Utilities oppose CNEG's proposal on this issue. As recognized in CNEG' Initial Brief at 38, the Utilities already work out arrangements with customers on a case-to-case basis in order to effect a limited time reduction in delivered volumes with the ability to increase deliveries back to base load volumes even if a delivery restriction remains in effect. The procedure is an informal one that no party has established that is either ineffective or unreasonable, the Utilities believe that the concerns of CNEG can be addressed in accordance with the existing informal practice.

8. Other Large Volume Transportation Issues

a. Accounting for Trading and Storage Activity

Vanguard claims that the Commission should adopt Vanguard's proposal to properly account for gas that pertains to imbalance trades, adding accounts to a pool, and rebilled customers. Vanguard Init. Br. at 8-9. The Utilities do not understand Vanguard's proposal. No other party complains about the Utilities' accounting practices in this regard. This suggests that

Vanguard's problem may be unique to Vanguard. In any event, Vanguard's proposal is simply too ambiguous to adopt.

b. <u>Excess Bank and Critical Surplus Day Unauthorized Overrun Charges</u>

While Multiut attacked these charges in its direct testimony (Multiut Ex. 1.0, 8), Multiut did not address these charges in its Initial Brief. No other party addressed this issue in its initial brief. The Utilities reaffirm their discussion of this issue in their Initial Brief. The Utilities also note that the propriety of these types of charges was upheld in *Abbott Laboratories, Inc. v. Illinois Commerce Comm'n*, 289 Ill.App.3d 705 (1997).

c. <u>Cash-outs Index</u>

As discussed under Section X(C)(1), the Utilities have proposed cycling requirements for their transportation customers. Essentially, a Peoples Gas transportation customer is to have its AB at least 70% full on November 30 and its AB no more than 35% full on March 31, while a North Shore transportation customer is to have its AB at least 85% full on November 30 and its AB no more than 24% full on March 31. To the extent that a transportation customer does not have its AB at the appropriate level on November 30, the Utilities would sell the shortfall to the customer at a price equal to 110% of the Average Monthly Index Price ("AMIP"). Correspondingly, to the extent that a transportation customer does not have its AB at the appropriate level on March 31, the Utilities would purchase the overage from the transportation customer at 90% of AMIP. Multiut attacks the 10% price premium on sales and the 10% price discount on purchases as unjustified penalties. Multiut Init. Br. at 5-7. Multiut is the only party in these proceedings to do so.

Multiut incorrectly claims that the Utilities "could make a 20% spread by buying and selling to the customer the same gas in storage". *Id*. at 7. This is not the case. The Utilities are cycling their storage assets as they are required to do for operational reasons in the case of Manlove and by the terms of their leased storage service contracts. Zack Dir., NS Ex. TZ-1.0, 12:267-15:351; PGL Ex. TZREV 1.0, 12:269-17:378. Furthermore, the economic benefit of the 10% premium or discount would not be retained by the Utilities; it would inure to the benefit of the Utilities' customers through their Gas Charge. *See* North Shore's Rider 2, Section D(f), NS Ex. VG-1.1, 31; Peoples Gas' Rider 2, Section D(f), PGL Ex. VG-1.1, 31. The premiums and discounts to which Multiut objects can easily be avoided by it if it acts as a responsible supplier and buys or sells its own gas to meet the required end of season inventory levels. These premiums and discounts act as appropriate and reasonable supplier incentive mechanisms from which the Utilities themselves do not profit, and they should be approved.

d. <u>Receipt of Service Classification, Rider, AB, MDQ and SSP Information –</u>

The Utilities are willing to make this information available on PEGASys™. Zack Sur., NS-PGL Ex. TZ-3.0, 33:726-736. The only issue is when that information would become available. Vanguard maintains that by signing the Utilities' "Customer Usage Data Contract" a large volume transportation supplier agrees to obtain the customer's approval before it receives the customer's consumption history. Vanguard Init. Br. at 9. Therefore, Vanguard claims that the Utilities should make this information available to the large volume transportation supplier when that supplier requests a customer's consumption history. *Id*. After considering the matter further, the Utilities are willing to accept Vanguard's position on this issue, so long as the Commission itself does not have a problem with the Utilities making the information available under these circumstances and as long as the information is made available only in connection with the Utilities' large volume transportation programs.

D. Small Volume Transportation Program (Choices For You[SM] or "CFY")

1. Storage Rights and Aggregation Rights

a. Specific Allocation of Storage Rights and Costs to CFY Customers (including the RGS Proposed Rider AGG)

RGS continues to claim that the costs that the Utilities recover through the Aggregation Balancing Gas Charge ("ABGC") are excessive relative to the storage rights CFY suppliers receive, and that as a result, CFY customers subsidize the Utilities' sales service. RGS Init. Br. at 7. The Utilities continue to dispute this claim. The Utilities believe that the record is clear that CFY supplies and customers receive balancing and storage services from the Utilities and the ABGC recovers those costs. Zack Reb., NS-PGL Ex. TZ-2.0, 49:1092 – 50:1118.

RGS continues to propose that the Utilities be compelled to assign to CFY suppliers substantially larger specific daily, monthly, seasonal and annual allocations of storage rights. RGS Init. Br. at 15. RGS proposal is overbroad and ignores the fact that the Utilities, rather than the CFY supplier, are responsible for handling CFY customer consumption changes as a result of weather changes and forecasting error under the CFY program. Zack Dir., PGL Ex. TZ-1.0REV 31:697-710; NS Ex. TZ-1.0, 29-30:670-683.

Most CFY customers are low-load factor heating degree day sensitive gas consumers, so the practical responsibility for making sure these customers receive their gas requirements falls squarely on the Utilities. RGS also ignores the fact that the Utilities' maximum storage injection and withdrawal capabilities decrease as the applicable injection or withdrawal season runs its course and the Utilities exercise their injection and withdrawal rights. NS-PGL Init. Br. at 113. RGS admits that the storage quantity target levels in RGS' proposed Rider AGG are more liberal than those in Nicor Gas Rider 16. RGS Init. Br. at 15. It claims that its analysis indicates that the on-system and off-system assets that CFY supplies and customers pay for support wider storage targets than those in Nicor Gas' Rider 16. *Id.* RGS has not and cannot not cite to any support in the record for this claim. In any event, this argument misses its mark, because the CFY suppliers and customers receive the balancing and storage services that they pay for.

RGS claims that CFY suppliers would be required to adhere to the Utilities' daily estimate of CFY customer consumption, and that CFY customer usage would be reconciled on a daily basis. RGS Init. Br. at 12. These claims are absolutely wrong. What a CFY supplier would be required to adhere to is its daily flow nominations that must be consistent with the required daily delivery quantity, subject to a 10% daily tolerance. CFY customer consumption is not daily metered, so CFY customers consumption usage would not, and cannot be, reconciled daily.

RGS also claims that the Utilities have provided no support for "bald claims" that the use of peak day data to establish daily injection and withdrawal parameters are problematic. RGS Init. Br. at 13. This claim also is wrong. NS-PGL witness Mr. Zack testified in rebuttal that maximum storage capabilities do not exist throughout the winter or throughout the summer, and no party has challenged this testimony. NS-PGL Ex. TZ-2.0, 48:1065-1066.

RGS unfairly implies that the Utilities were uncooperative in the discovery process by claiming that RGS witness Crist "was unable to calculate daily withdrawal and injection rights in his direct testimony because he was waiting for the [Utilities] to respond to data requests designed to elicit data necessary to make such a calculation." RGS Init. Br. at 14. The facts do not support this claim. The Utilities filed their direct testimony March 9, 2007. RGS did not serve these data requests on the Utilities until June 21, which is three and one-half months after the direct testimony was filed and only eight days before RGS' own direct testimony was due.

The Utilities responded to the data requests by June 29, or just eight days after they were served with them. The Utilities' response was extremely prompt and it is unreasonable to suggest that the Utilities dragged their feet, as RGS implies by stating that "the Company eventually provided enough data". RGS Init. Br. at 14.

RGS also incorrectly claims that the Utilities never claimed that RGS' proposed Rider AGG was faulty or that Mr. Crist misinterpreted or misunderstood the storage rights that the Utilities had under contract. RGS Int. Br. at 16. On the contrary, NS-PGL witness Mr. Zack testified that Mr. Crist's proposal was convoluted and contained numerous undefined terms and requirements and vague conditions. NS-PGL Ex. TZ-3.0, 29:634-642.

b. Aggregation Balancing Gas Charge (ABGC)

The Utilities have proposed to bill this charge directly to CFY customers instead of to CFY suppliers. Neither RGS nor any other party opposes this billing treatment.

c. Pipeline Capacity Assignment

RGS proposed, as a less preferred alternative to RGS' proposed Rider AGG, that the Utilities be required to release the capacity associated with the assets that flow through the ABGC. RGS Init. Br. at 17. The Utilities also oppose this alternative. NS-PGL Init. Br. at 117. RGS claims that "[M]any other utilities conduct capacity release programs every day to enable suppliers to manage their obligations." RGS Init. Br. at 17. However, RGS identifies only three such utilities. *Id.*, at 17-18. Furthermore, none of those three utilities operate in Illinois. The Utilities confirm the position expressed in their Initial Brief on this issue.

d. Customer Migration

RGS complains that, as far as the allocation of the amount of seasonal storage capacity is concerned, the Utilities only take customer migration into account during the injection season, but not during the withdrawal season. RGS Init. Br. at 18-19. The Utilities admit that this is true, and they rely on the justification for this practice set forth in their Initial Brief.

e. Month End Delivery Tolerance

The Utilities have proposed to increase the month-end delivery tolerance for CFY suppliers from 2% of Monthly Adjusted Deliveries to 5%. RGS wants to either eliminate the month-end delivery tolerance approach entirely or to increase it from 2% to 10%. RGS Init. Br. at 20-21. Commission Staff believes that RGS' proposal should be rejected because it would make it more difficult for the Utilities to plan their purchases as well as their storage injections and withdrawals if the monthly tolerance is too large which would result from adopting the RGS proposal. Staff Init. Br. at 260. The Utilities similarly reject RGS' proposal for the reasons set forth in their Initial Brief.

f. Working Capital Related to System Gas Costs/Monthly Customer Aggregation Charge

The Utilities have agreed with RGS that it is appropriate that their working capital costs related to their own gas costs not be allocated to CFY customers, and they each have proposed to include a credit from working capital in the CFY customer Aggregation Charge. NS-PGL Init. Br. at 119. The credit proposed by Peoples Gas would eliminate the per customer Aggregation Charge and still leave a remaining credit of 83 cents per customer per month. RGS recommends that the credit be applied to the ABGC. RGS Init. Br. at 22.

While the Utilities agreed to grant the credit RGS seeks, they do not think that the credit should be applied to the ABGC. The credit arises under each Utility's Rider AGG and therefore it is a credit that the supplier, rather than the customer, receives. Applying the credit to the ABGC would affect the gas cost reconciliation with revenues that are not recoverable gas costs.

Also, the credit is a per customer credit while the ABGC is a per therm charge and it is unclear how the per customer credit would be integrated into the per therm ABGC.

2. Customer Enrollment

a. Customer data issues

The Utilities' position on customer data issues is substantially set forth in their Initial Brief. However, the Utilities will respond – briefly – to an inflammatory assertion by Nicor Advanced Energy (NAE) that their "proposals generally disadvantage all CFY suppliers – except perhaps Integrys Energy Systems (the Companies' supplier affiliate)". NAE Init. Br. at 1. NAE cites to no support for this assertion in the record in these proceedings. The obvious reason for NAE's failure to cite to support in the record is that there is absolutely no support in the record for this claim.

RGS incorrectly claims that the Utilities have agreed to provide Tier 1 and Tier 2 data for free. RGS Init. Br. at 23. This is incorrect. The Utilities consistently have proposed to make Tier 1 and Tier 2 data available only pursuant to the terms of a contract, the terms of which would include compensation for the Utilities. NS-PGL Ex. TZ-3.0, 34:751-757. Similarly, NAE incorrectly claims that the Utilities have committed to provide customer telephone numbers to CFY suppliers. NAE Init. Br. at 7-8. The NS-PGL witness rebuttal testimony to which NAE cites (NS-PGL Ex. TZ-2.0, 55:1212-1218) does not address telephone numbers. It says that no data about customers on the CFY "do not contact" list will be made available to CFY suppliers. Curiously, NAE argues in the next paragraph of its Initial Brief that names, addresses and phone numbers of potential customers are available from many public information sources, including the White Pages and the internet. This argument certainly undercuts CFY supplier arguments for compelling the Utilities to make this information available to the CFY suppliers.

b. **<u>Evidence of Customer Consent</u>**

The need for a definition of adequate evidence of customer consent is discussed in the Utilities' Initial Brief (at 208). However, the Utilities do need to respond to a position articulated by Staff in its Initial Brief. Staff notes that several marketers offer Nicor Gas' program for the release of customer information, and that that program uses a system that has not drawn many complaints. Staff Init. Br. at 262. Staff then states that it would not object to modeling the Utilities' method on Nicor Gas' method, if it is explicit. *Id.* The Utilities have a problem with this approach. They do not want to adopt a method based on that used by Nicor Gas, only to find out after the fact, that such method "is not explicit." The Utilities should be able to know whether a method would satisfy Dr. Rearden's "explicit" criterion before they invest the time and energy into adopting it.

c. **<u>Minimum Stay Requirement</u>**

The Utilities addressed the reasons justifying the minimum stay requirement in their Initial Brief. However, the Utilities do feel compelled to respond to RGS' argument that the Utilities' one year minimum stay period is anticompetitive. RGS Init. Br. at 26. Just one page later it argues that suppliers contracts are usually one year in length or more and impose exit fees that disadvantage customers from switching back and forth between suppliers and the Utilities. *Id.* at 27. The Utilities do not understand how their one year minimum stay requirement is anticompetitive while the RGS suppliers "one year or more" contract term is not anticompetitive.

3. **<u>Rider SBO</u>**

a. **<u>Billing Credit</u>**

NAE initially proposed that the Utilities provide CFY suppliers that single bill under Rider SBO a credit for single billing, to reflect costs avoided by the Utilities by not having to issue a bill for their distribution charges. Initially, the Utilities resisted NAE's proposal, but ultimately they agreed to provide a 33 cents per customer per month credit, reflecting their estimate of postage and paper costs. The Utilities believed that this reflected a reasonable resolution of this issue. However, NAE is not satisfied. It wants the Utilities to be ordered to conduct an embedded cost of service study to determine their billing costs and be required to file a revised Rider SBO billing credit to reflect the results of the cost study. NAE Init. Br. at 11.

The Utilities oppose NAE's further demands on this issue. NAE is the only marketer that has expressed any interest in using the Utilities' Rider SBO. The Utilities do not believe that it would be an efficient use of resources to conduct an embedded cost of service study to determine their billing costs just to satisfy NAE.

NAE also disingenuously claims that it is "remarkable" that the Utilities have prepared no cost study to analyze their costs when a CFY supplier bills under Rider SBO. NAE Init. Br. at 12. Given that to date no CFY supplier has elected to obtain service under Rider SBO, there are no cost data available to the Utilities with which to conduct such a study. In addition, NAE takes the curious position that "under no circumstances should the Commission approve a Rider SBO billing credit of less than $0.33 per bill per month." NAE Init. Br. at 14. If the Utilities do have to undertake some sort of embedded cost study concerning SBO billing, the Utilities certainly also will examine whether there are any offsetting costs which they incur as a result of not billing for their delivery services. If a study is to be conducted, there certainly is no logic for the Utilities to be stuck with a floor for a billing credit without being able to take into account all costs, both positive and negative.

b. **<u>Order of Payments</u>**

RGS and NAE both complain of the Utilities' proposal to have all partial payments made under either Rider SBO or under the Utility's consolidated billing apply to all Utility receivables before any payment is made to a CFY supplier. However, they each have different agendas.

While RGS complains about it, it really is unhappy with either the Utilities' existing or proposed allocations of payments because it is afraid that its customers will only pay the Utility portion of a bill to avoid disconnection. RGS Init. Br. at 30. What it is unhappy about is the fact that selling gas to customers entails credit risks, and it seeks to shift those risks to the Utilities. The Utilities will address this in more detail in Section X(D)(4) *infra*.

NAE wants an "aged receivables" order of payment methodology currently used under the Utilities' consolidated billing to be applied to Rider SBO partial payments. NAE Init. Br. at 17. In doing so, it characterizes the Utilities' response to NAE's proposal as being "flippant", and maintains that the Utilities' argument in support of their position is "nonsense". *Id.* As explained in their Initial Brief, the Utilities' proposals resulted from the Rider SBO order of payments approved by the Commission in ICC Docket Nos. 01-0469 and 01-0470. Also, under Section 16-118(b) of the PUA, partial customer bill payments made by retail electric customers are to be credited first to the electric utility's tariffed services, regardless of whether the electric utility or the alternative retail electric supplier issues the single bill to the retail customer. The Utilities certainly have a logical basis for their proposal to conform the order of payments to that legislatively mandated for use of the single bill option in connection with electric service. The legislative directive reflected in Section 16-118 certainly is not "nonsense".

c. **<u>NSF Checks</u>**

NAE wants each Utility and the CFY supplier to bear the risk associated with its own charges when a CFY customer pays with an NSF check, regardless of whether the CFY supplier or the Utility takes the check. NAE Init. Br. at 18-19. The Utilities continue to disagree with NAE. They continue to believe that the party taking an NSF check from a customer bears the collection risk for that check, for the reasons set forth in their Initial Brief (at 213-214).

4. **<u>Purchase of CFY Supplier Receivables</u>**

North Shore's and Peoples Gas' Initial Brief showed that the Commission should reject RGS' request that the Commission force the Utilities to purchase the receivables of CFY suppliers, because: (1) Peoples Gas and North Shore are not in the business of offering purchase of receivables or bad debt collection services to third parties, they do not wish to offer these services, and their information systems and business processes are not set up to provide this service; (2) RGS' proposal is an inappropriate attempt to shift business risks from CFY suppliers to the Utilities and utility customers; (3) RGS' proposal inappropriately and incorrectly contemplates that the Utilities should and would be able to invoke, and carry out, the threat of disconnection of their customers, even when those customers are current on their obligations to the Utilities; (4) RGS' vague proposal, at least as presented in testimony, provides for no discount, no other compensation, and no means for the Utilities to recover the added risks, costs, and expenses that would be taken on by the Utilities; and (5) RGS' argument that Senate Bill 1299, which applies only to electric utilities, supports RGS' proposal, is not reasonable, because the General Assembly chose not to extend the requirement of a purchase of receivables ("POR") program to gas utilities, and, indeed, RGS did not make the evidentiary record that would be required to establish such as program as to the applicable electric utilities under the Bill. NS-PGL Init. Br. at 214-217.

Staff's Initial Brief, citing the rebuttal testimony of Staff witness Dr. Rearden (Staff Ex. 24.0, 23:453 – 24:470), also opposes RGS' proposal. Staff agrees that the proposal will result in increased risks for the Utilities, especially if the POR program encourages suppliers to target customers at a high risk of default, and Staff "is concerned about the legitimacy of holding utility service hostage to payment of a bill for a competitive service." Staff Init. Br. at 264.

RGS' Initial Brief still advocates RGS' proposal (RGS Init. Br. at 32-37), but does not refute the grounds identified above for rejecting the proposal. Nicor Advanced Energy's ("NAE") Initial Brief, surprisingly, based on no supporting testimony, in a single paragraph, proposes to expand RGS' proposal to cover not only CFY suppliers that use the LDC billing option (utility consolidated billing) but also CFY suppliers that elect the Supplier Bill Option Service, under which the supplier bills the supplier's supply charges and the Utilities' charges. NAE Init. Br. at 20. NAE's Initial Brief cites no evidence that supports its proposed expansion nor provides any details.

RGS' Initial Brief suffers from many flaws on this subject. RGS belatedly tries to provide a few of the many essential details that have been missing from its proposal. For example, RGS' witness discussed, at a high level of abstraction, how utilities have been made whole in other jurisdictions when they undertook POR programs (Crist Dir., RGS Ex. 1.0, 31:2-13), and RGS' Initial Brief now cites that testimony as if he had actually proposed in his written testimony that those measures be adopted here. RGS Init. Br. at 32. He did not do so, and he gave no details. RGS also tries to supply some missing specifics by citing its witness' testimony at the evidentiary hearing, where he proposed that there should be an increase in the uncollectibles expenses in the Utilities' revenue requirements to cover the additional bad debt they would incur under the POR program. RGS Init. Br. at 32 (citing Crist, Tr. at 1026). RGS' witness made no such proposal in his written testimony, and even at the hearing, he provided no details and numbers from which such increases could be calculated. That is too little as well as too late. RGS also seeks to evade the complaint that its proposal lacks numerous essential details by pointing to the existence of POR programs in other jurisdictions. RGS Init. Br. at 36. That does not alter that RGS did not make a proposal here that had sufficient detail to allow its adoption, even setting aside its lack of merit.

RGS claims that the Utilities already have the information systems and business processes needed to implement the proposed POR program, citing its witness' inferences and speculation. *See* RGS Init. Br. at 34.[49] RGS' claim is not true. *E.g.*, Borgard Sur., NS-PGL Ex. LTB-3.0, 9:178-191.

RGS' Initial Brief (at 32) asserts that there is no evidence that the rate of bad debt would be higher than the Utilities' current rates of bad debt. Yet, on the very next page (at 33), RGS states that, with a POR program, suppliers will not obtain customer payment histories of or perform credit checks as to potential customers, because the Utilities will guarantee that the suppliers will be paid. RGS' position is internally contradictory and lacks credibility. Moreover, a supplier could bill improper or excessive charges to a customer, and the Utilities would be forced to try to collect the charges, and to threaten disconnection.

RGS implausibly claims that the POR program would not shift risks to the Companies (RGS Init. Br. at 35), but then acknowledges that the Utilities would need to be made whole (*id.*),

[49] RGS correctly notes that the Utilities do provide consolidated billing service (RGS Init. Br. at 34), but that only means that the Utilities turn over customer payments to suppliers. That is far different from the Utilities having to pay suppliers whether their customers pay or not, which is RGS' proposal in these proceedings.

something which, again, RGS did not propose in written testimony and for which RGS did not provide sufficient specifics. RGS also points to Mr. Zack's testimony, but Mr. Zack was not assuming a POR program. *See* RGS Init. Br. at 35.

RGS, being unable to refute the factual and legal concerns that the Utilities and Staff have established regarding disconnections, referenced above, seeks to brush aside those concerns by labeling them as anti-competitive. *See* RGS Init. Br. at 36. That is no answer, it is a slogan.

Finally, RGS once again cites Senate Bill 1299 (RGS Init. Br. at 37), but, as noted above, that bill provides no support for RGS' proposal, and RGS did not even meet the standards of that bill. RGS' proposal should not and cannot be adopted based on the evidence in the record.

5. PEGASys™ and Customer Information

RGS and NAE continue to advocate that the Utilities be compelled to complete their planned improvements to PEGASys™ within thirty days of the issuance of a final order in these proceedings. For the reasons more fully set forth in their Initial Brief (at 217-218), the Utilities oppose being compelled to honor an artificial deadline to complete these improvements. Curiously, NAE cites to comments made by RGS in its direct testimony claiming that Peoples Gas' data management system "is the worst among all customer choice programs." NAE Init. Br. at 20, footnote 12. While the Utilities do not agree with RGS' comments, they also would observe that, if they were true, that would be an argument in support of giving the Utilities more time to get the improvements done right, not less.

E. Tariff Corrections and Clarifications

The Utilities have proposed six corrections and clarifications to the proposed transportation tariffs, one of which was made moot by the Utilities' proposed changes to Rider SST in their surrebuttal testimony. Zack Reb., NS-PGL Ex. TZ-2.0, 63:1408-65:1453.

Each is listed below. The Utilities also proposed a clarification to their Terms and Conditions of Service. No party has objected to any of them, and they all should be accepted by the Commission.

1. <u>Rider SST, Section F</u>

Rider SST, Section F, includes a monthly limitation on withdrawals from the AB, but it is not clear what happens if the monthly limit is exceeded. The implication from Section E, which defines the daily order of deliveries to the customer, is that gas taken in excess of the lesser of one-third or inventory limitation would be purchased under the companion classification up to the SSQ. However, the Utilities propose to make that clear by adding the following sentence to the end of the last paragraph in Section F: "For quantities that would be in excess of this limitation, the customer shall purchase gas under the Companion Classification in a quantity not to exceed the product of the SSQ times the number of days in the month minus standby service gas purchased during the month and any remaining quantity shall be Unauthorized Use."

2. <u>Rider TB, Section A</u>

For Peoples Gas, the Rider TB calculation of the Imbalance Coincidence Factor should be limited to data associated with S.C. No. 4 customers. Only S.C. No. 4 customers are eligible for Rider TB, and only their data should be used. Consequently, Peoples Gas proposes to add in Rider TB, Section A, Imbalance Coincidence Factor, a new sentence before the last sentence of the definition: "For purposes of determining the ICF, the Company shall use only Service Classification No. 4 customers' data."

3. <u>Rider LST-T</u>

If the Commission approves Peoples Gas' proposal to consolidate S.C. Nos. 3 and 4, then the Daily Demand Measurement Device Charge will not be assessed under Rider LST-T because daily metering is an incident of service under S.C. No. 4. However, the language pertaining to the customer's obligations relating to telephone wiring needs to be maintained. Accordingly, Peoples Gas proposes to delete the charge from Section B of Rider LST-T and add the non-charge language to Section J of Rider LST-T.

4. Rider SST, Section H

A proposed change to Rider SST, Section H, was made moot by the Utilities' proposed changes to Rider SST in their surrebuttal testimony.

5. Rider SST, Section K

Rider SST, Section K, addresses customers who do not yet have daily metering installed. There is a minimum AB requirement and a gas purchase obligation if the minimum AB is not met. The Utilities proposed that the purchase price be 110% of the greater of the Gas Charge or the Average Monthly Index Price ("AMIP"). For simplicity, the Utilities propose that the price simply be 110% of the AMIP.

6. Rider TB, Section H and Rider P, Section G

The imbalance trading provision in Rider TB, Section H, could result in customers trading gas beyond the amount of their imbalance. The function of a trade for these customers should be to reduce or eliminate the imbalance and not to create another imbalance. For example, a customer should not be able to trade negative imbalance gas such that it is in a positive imbalance situation. The Utilities propose that the following be added to the second paragraph of Section H: "or increase the amount of the imbalance." A comparable change in Rider P, Section G, would be appropriate.

7. Terms and Conditions of Service[50]

a. Service Activation Charges

The Utilities propose to increase the Service Activation Charge, which recovers a portion of the costs related to initiating gas service at a premises. Grace Dir., PGL Ex. VG-1.0 2REV, 29:641-642; NS Ex. VG-1.0 3REV, 25:549-550. There are two types of service activations: a "successor turn-on," and a "straight turn-on." A successor turn-on occurs when the customer moving out calls and discontinues gas service at approximately the same time as the applicant moving in calls and request gas service. In this instance only a meter reading is required. A straight turn-on occurs when there has never been gas at the location, or when the prior customer cancelled service and the gas has actually been turned off before new service is requested. In this instance the gas has to be turned on and the appliances relit. *Id*.

Both North Shore and Peoples Gas performed a study on these charges. The results are shown in NS Ex. VG-1.9 and PGL Ex. VG-1.10. Both studies show the cost is higher than the respective Company's proposed change in this consolidated docket: Harden Dir. Staff Ex. 9.0, 7:144-8:152. North Shore proposes charging $18.00 for a successor turn-on, and $28.00 for a straight turn-on including the relighting of four appliances, plus $5.00 for the fifth and each additional appliance to be activated. Grace Dir., NS Ex. VG-1.0 3REV, 26:562-567. Peoples Gas proposes charging $12.00 for a successor turn-on, $20.00 for a straight turn-on, including the relighting of four appliances, plus $5.00 for the fifth and each additional appliance to be activated. Grace Dir., PGL Ex. VG-1.0 2REV, 30:657-659.

---

50 This subsection concerns sales customers, not transportation customers. Its inclusion here is an artifact resulting from the negotiation of the joint outline for these briefs.

Staff witness Ms. Harden has reviewed the supporting documentation and agrees with the changes proposed by North Shore and Peoples Gas. Harden, Staff Ex. 9.0, 8:157. No other parties addressed this matter.

b. Service Connection Charges

A Service Reconnection Charge is a charge assessed to a customer whose gas haspreviously been turned off for any number of reasons, such as nonpayment of bills or the customer's own request. Grace Dir., PGL Ex. VG-1 .0 2REV, 30:670-31:677; NS Ex. VG-1 .0 3REV, 27:578-580. Each customer is granted a waiver of one reconnection charge each year, except in the situation where the customer voluntarily disconnects and then requests reconnection within twelve months, or in the situation in which service is disconnected at the main. Grace Dir., PGL Ex. VG-1.0 2REV, 30:672-31:675; NS Ex. VG – 1.0 3REV, 27:580-583.

As with the Service Activation Charge, the Utilities propose to restructure the Service Reconnection Charge to include a basic charge that includes the relighting of up to four appliances, and to assess a charge for the fifth and each additional appliance. The Utilities are proposing a slight increase to the charges for all three types of reconnection: (1) basic reconnections which only require a meter turn-on; (2) reconnections which require the Company to set a meter; and (3) reconnections that involve excavating at the main. Grace Dir., PGL Ex. VG-1.0 2REV, 30:671-31:678; NS Ex. VG-1.0 3REV, 27:579-586.

North Shore proposes charging $50.00 for a basic reconnection, $90.00 if the meter has to be reset, and $275.00 if service has to be reconnected at the main. Grace Dir., NS Ex. VG-1.0 3REV, 27:596-600. Peoples Gas proposes charging $50.00 for a basic reconnection, $100.00 for a reconnection when the meter has to be reset, and $275.00 when service has to be reconnected at the main. Grace Dir., PGL Ex. VG-1.0 2REV, 3 1:687-695.

The Companies provided the results of a study on these charges in ns Ex. VG-1.9 and PGL Ex. VG-1.10. Both studies show the actual cost is even higher than the charge the Companies are proposing in this consolidated docket.

c. **<u>Second Pulse Data Capability</u>**

Certain meters, meter correctors, and daily demand measurement devices are capable of delivering a "second pulse" signal to specialized devices that can capture and transmit metering data. Second Pulse Data Capability can provide this signal and make real-time usage readings to customers. While the Companies does not require such capability, a few large volume customers have made requests to receive the second pulse output to help manage their gas usage. Grace Dir., PGL Ex. VG-1.0 2REV, 33:725-730, NS Ex. VG-1.0 3REV, 29:633-638. The Utilities proposes a charge of $14.00, set at cost, to customers who elect Second Pulse Data Capability. Grace Dir., PGL Ex. VG-1.0 2REV, 33:737-738; NS Ex. VG-1.0 3REV, 30:645-646.

Staff witness Ms. Harden has reviewed North Shore and Peoples Gas' supporting documentation and agrees to the monthly charge for Second Pulse Data Capability. Harden Dir., Staff Ex. 9.0, 12:245-246. No other Parties have addressed this issue.

North Shore and Peoples Gas also propose to revise the first sentence of the second paragraph of the section entitled "Second Pulse Data Capability" to state "Initial terms of the contract shall end on the first April 30 following the effective date thereof, and the contract shall automatically renew for one-year periods upon expiration of the initial term and each one-year extension." This change does not substantially affect the second pulse proposal. The change was made for consistency since many of the contracts automatically rollover on May 1. Grace Sur., NS-PGL Ex. VG-3.0, 29:615-623.

XI. UNION PROPOSALS

Local 18007 has filed an initial brief of 23 pages, all on this one issue. It is primarily devoted to recounting all the testimony of its witness, Mr. Gennett. While set out in considerable detail, the union's arguments are not persuasive: Local 18007 has not and cannot make a compelling argument as to why the Commission should insert itself into a domain reserved for management. Peoples Gas should be permitted to determine the right size of its workforce, and to promote and hire employees as necessary to meet its needs. While it may well be true that Peoples Gas workforce is "doing more with fewer people" (Gennett Dir., Ex. No. UWUA-1.0, 10:15-19), and that may not sound good to Local 18007, to Peoples Gas and its ratepayers that sounds like efficiency.

To overcome the appropriate boundary between the Commission and a regulated utility as to management decisions, the Commission would need to find that something was quite wrong: that utility service was seriously suffering. Despite taking 23 pages to walk through all their evidence, the best the brief demonstrates is that, in the union's opinion, there are too many "temporary repairs" and on occasion they take too long to replace with permanent repairs.

There are two problems with this argument. First, there is no evidence that the temporary repairs are themselves unsafe. Questioned at length on this issue at the hearing, Mr. Doerk made abundantly clear that temporary repairs were not unsafe, and that workers were explicitly trained not to leave a site if conditions were unsafe. Doerk, Tr. at 230:11-14; 231:4-8; 234:8-22. If a permanent repair isn't available, and a temporary repair would not cure the hazard, the temporary solution would be to cut the customer's gas off. Doerk, Tr. at 236:14-21. A temporary repair is designed to keep the site safe until a permanent repair can be effected. Doerk, Tr. at 231:4-8; 238:22-239:6.

Second, there is no evidence demonstrating that, through personnel shortages, permanent repairs are being systematically or chronically delayed. The Field Service Manual calls for temporary repairs to be replaced by permanent repairs "within a reasonable time period, typically no more than 5 business days." Gennett Reb., Ex. No. UWUA-2.05. Local 18007's evidence is limited to an isolated anecdote in which a temporary repair was not replaced for 29 days, where the permanent repair would mean temporarily cutting off gas to a hospital. Doerk Reb., NS-PGL Ex. ED-2.0, 4:71-80. That anecdote does not establish a problem, and does not establish any real safety issue.

Local 18007 also contends that Peoples Gas' decision to hire eight outside contractors to help with a routine, but seasonal chore: cutting service to non-paying customers before the winter season begins. As Local 18007 concedes, this is an assignment that can safely be entrusted to entry-level employees, so there is no safety issue here. Doerk, Tr. at 244:20 - 245:16; Local 18007 Init. Br. at 14-16. Union employees were shifted to safety inspections during this period. Doerk, Tr. at 250:15-20. The union would rather that Peoples Gas use union employees for everything, but this is an example of a seasonal job that involves intensive activity for a short period. Peoples Gas is not acting unreasonably to staff that seasonal task with temporary contract workers, as opposed to hiring new permanent workers to do a temporary job.

On the basis of this evidence, it is not reasonable to ask that the Commission impose a requirement that Peoples Gas promote people, even when it does not believe that it needs any more workers in the more senior position. Local 18007's offer of an exception for "technological changes or infrastructure improvements" is illusory. It would still hamper Peoples Gas' ability to decide it doesn't need someone in the vacated senior position. That is something the company should be allowed to do, and the union disagrees. The union's "technology" carve-out would just set up a new burden of proof on the utility that it does not have today, and set the stage for a new set of arguments.

Local 18007 also has not established the elements they would need to establish to justify their requested audits. 220 ILCS 5/8-102. Local 18007 wants an audit of repair work, and an audit of staffing levels. Neither is warranted. As discussed above, the testimony in this case does not establish the kind of problems that would lead to an audit of repairs. Peoples Gas already has established a compliance monitoring group that audits compliance with the Field Service Manual. Doerk, Tr. at 228:17-22. The Commission does not have before it any bona fide safety or service issues warranting the cost and disruption of a formal ICC-ordered audit. This is particularly true given the audits already under way, perhaps on overlapping issues. It is hard to imagine what would justify a Commission audit of staffing levels, but it is clearly unwarranted by anything in the record here.

XII. CONCLUSION

Accordingly, for the reasons appearing of record and the reasons stated in their Initial Brief and herein, Peoples Gas and North Shore respectfully request that the Commission enter findings and make conclusions on all contested issues consistent with the Utilities' positions taken in testimony and/or stated in their Initial Brief and herein regarding the evidence in the record and the applicable law.

Dated: October 23, 2007

By

John P. Ratnaswamy

John P. Ratnaswamy
Christopher P. Zibart
Bradley D. Jackson
FOLEY & LARDNER LLP
321 N. Clark Street, Suite 2800
Chicago, Illinois 60610
(312) 832-4500
jratnaswamy@foley.com
czibart@foley.com
bjackson@foley.com

Gerard T. Fox
Mary P. Klyasheff
INTEGRYS ENERGY GROUP, INC.
130 East Randolph Street
Chicago, Illinois 60601
(312) 240-4341
gtfox@integrysgroup.com
mpklyasheff@integrysgroup.com

Emmitt C. House
Timothy W. Wright
Jerome Mrowca
GONZALEZ, SAGGIO & HARLAN, L.L.C.
35 E. Wacker Drive, Suite 500
Chicago, Illinois 60601
(312) 638-0012
emmitt_house@gshllp.com