

**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.	:	

**DRAFT PROPOSED ORDER OF NORTH SHORE GAS COMPANY
AND THE PEOPLES GAS LIGHT AND COKE COMPANY**

October 23, 2007

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THE PEOPLES GAS LIGHT AND COKE COMPANY	:	Consol.
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PROPOSED ORDER

By the Commission:

PROCEDURAL HISTORY

On March 9, 2007, North Shore Gas Company filed with the Illinois Commerce Commission (the "Commission"), pursuant to Section 9-201 of the Public Utilities Act (the "Act") (220 ILCS 5/9-201), the following tariff sheets: ILL. C.C. No. 17, Original Title Sheet (cancelling ILL. C.C. No. 16 in its entirety) and ILL. C.C. No. 17, Original Sheet Nos. 1 through 130. This tariff filing embodied a proposed general increase in gas service rates, three new "tracker" Riders, and revisions of other terms and conditions of service. The tariff filing was accompanied by direct testimony, other exhibits, and other materials required under Parts 285 ("Part 285") and 286 ("Part 286") of Title 83 of the Illinois Administrative Code (the "Code"), 83 Ill. Admin. Code Parts 285 and 286.

On March 9, 2007, The Peoples Gas Light and Coke Company ("Peoples Gas") filed with the Commission, pursuant to Section 9-201 of the Act, the following tariff sheets: ILL. C.C. No. 28, Original Title Sheet (cancelling ILL. C.C. No. 27 in its entirety) and ILL. C.C. No. 28, Original Sheet Nos. 1 through 143. This tariff filing embodied a proposed general increase in gas service rates, four new "tracker" Riders, and revisions of other terms and conditions of service. The tariff filing was accompanied by direct testimony, other exhibits, and other materials required under Parts 285 and 286.

Notice of the proposed tariff changes reflected in this rate filing was posted in North Shore's and Peoples Gas' (the "Utilities" or "Companies") business offices and published in secular newspapers of general circulation in the Utilities' respective service areas, as evidenced by publishers' certificates, in accordance with the requirements of Section 9-201(a) of the Act, 220 ILCS 5/9-201(a), and the provisions of 83 Ill. Admin. Code Part 255.

The Commission issued Suspension Orders as to North Shore's tariff filing on April 4, 2007, suspending the tariffs to and including August 5, 2007, and initiating ICC Docket No. 07-0241. On July 25, 2007, the Commission issued a Resuspension Order, suspending these tariffs to and including February 5, 2008.

The Commission issued Suspension Orders as to Peoples Gas' tariff filings on April 4, 2007, suspending the tariffs to and including August 5, 2007, and initiating ICC Docket No. 07-0242. On July 25, 2007, the Commission issued a Resuspension Order, suspending these tariffs to and including February 5, 2008.

On April 23, 2007, the Commission's Staff ("Staff") filed a motion to consolidate ICC Docket Nos. 07-0241 and 07-0242, pursuant to 83 Ill. Admin. Code §200.600.

Pursuant to notice duly given in accordance with the law and the rules and regulations of the Commission, a pre-hearing conference was held in the two Dockets before duly authorized Administrative Law Judges (the "ALJs") of the Commission, at its offices in Chicago, Illinois, on April 25, 2007, and April 27, 2007. More than ten days prior to April 25, 2007, notice of this status hearing had been provided by the Chief Clerk of the Commission to municipalities in the Utilities' service areas, in accordance with the requirements of Section 10-108 of the Act, 220 ILCS 5/10-108. On April 25, 2007, at the status hearing, after addressing certain aspects of how consolidation would affect the conduct of these cases, the Administrative Law Judges (the "ALJs") granted Staff's motion to consolidate.

Petitions to Intervene were filed or appearances were entered on behalf of the Attorney General of the State of Illinois (the "Attorney General" or "AG"); the Citizens Utility Board ("CUB"); the City of Chicago (the "City") (collectively, CUB and the City are "CUB-City" or "City-CUB", their having used both terms in different filings) (collectively, the AG, CUB, and the City are "GCI" for "Governmental and Consumer Intervenors"); Constellation NewEnergy-Gas Division, LLC ("CNEG" or "CNE-Gas"); the Environmental Law and Policy Center ("ELPC"); the Illinois Industrial Energy Consumers ("IIEC"); Multiut Corporation ("Multiut"); Local Union No. 18007, United Workers Union of America, AFL-CIO ("UWUA"); Prairie Point Energy, LLC, d/b/a Nicor Advanced Energy, LLC ("NAE"); Retail Gas Suppliers ("RGS") an ad hoc group comprised of Dominion Retail Incorporated; Interstate Gas Supply; and U.S. Energy Savings Corporation; and Vanguard Energy Services, LLC ("Vanguard") (collectively, all of the foregoing parties are the "Intervenors").

Evidentiary hearings were held on September 10, 2007 through September 12, 2007, September 14, 2007, and September 17, 2007 at the offices of the Commission in Chicago, Illinois. At the evidentiary hearings, the Utilities, the Staff of the Commission ("Staff"), and the Intervenors, entered appearances and presented testimony, either by live witness(es) or by affidavit(s). Certain additional materials were received into the record thereafter by order of the ALJs. On _____, 2007, the ALJs marked the record "Heard and Taken".

The following witnesses testified on behalf of the Utilities: Michael J. Adams, Director, Navigant Consulting, Inc.; Ronald J. Amen, Director, Navigant Consulting, Inc.; Lawrence T. Borgard, President and Chief Operating Officer, The Integrys Gas Group, and Vice Chairman of the Board and Chief Executive Officer, Peoples Gas and North Shore; Edward Doerk, Vice President, Gas Operations, Peoples Gas and North Shore; Russell A. Feingold, Managing Director, Navigant Consulting, Inc.; Salvatore Fiorella, Manager, State Regulatory Affairs, Peoples Gas (he retired from this position during these proceedings); Valerie H. Grace, Manager, Rates Department, Peoples Gas, and, subsequently, Manager, Regulatory Affairs; James C. Hoover, Director, Compensation, Integrys; Bradley A. Johnson, Treasurer, North Shore; Linda

M. Kallas, Vice President, Financial Accounting Services, Peoples Gas; Brian M. Marozas, Coordinator, Trading Risk Management Department, Peoples Gas; Paul R. Moul, Managing Consultant, P. Moul & Associates; Joseph P. Phillips, Vice President, Information Technology, Integrys Business Support; Thomas L. Puracchio, Gas Storage Manager, Peoples Gas; Ilze Rukis, Manager, Alternative Resources, Wisconsin Public Service Corporation; James F. Schott, Vice President, Regulatory Affairs, Integrys Energy Group, Inc. and Peoples Gas; Eugene S. Takle, Professor of Atmospheric Science and Agricultural Meteorology, Co-director, Regional Climate Modeling Laboratory, Iowa State University; Frank L. Volante, Operations Manager, North Shore; Thomas E. Zack, Vice President, Gas Supply, Integrys.

The following witnesses testified on behalf of Staff: Dennis L. Anderson, Senior Energy Engineer, Engineering Department, Energy Division; Janis Freetly, Senior Financial Analyst, Finance Department, Financial Analysis Division; Thomas L. Griffin, Accountant, Accounting Department, Financial Analysis Division; Cheri L. Harden, Rate Analyst, Rates Department, Financial Analysis Division; Diana Hathhorn, Account, Accounting Department, Financial Analysis Division; Daniel G. Kahle, Accountant, Accounting Department, Financial Analysis Division; Sheena Kight-Garlish, Senior Financial Analyst, Finance Department, Financial Analysis Division; Peter Lazare, Senior Economic Analyst, Rates Department, Financial Analysis Division; Eric Lounsberry, Supervisor, Gas Section, Engineering Department, Energy Division; Mike Luth, Analyst, Rates Department, Financial Analysis Division; Bonita A. Pearce, Accountant, Accounting Department, Financial Analysis Division; Dr. David Rearden, Senior Economist, Policy Program, Energy Division.

GCI's witnesses were Michael L. Brosch, Principal, Utilitech, Inc.; David J. Effron, Consultant; William L. Glahn, Principal and Owner, Piedmont Consulting, Inc., except that the City did not sponsor certain specified testimony of Mr. Brosch.

CUB-City's witnesses were Christopher C. Thomas, Director of Policy, CUB; Jerome D. Mierzwa, Principal and Vice President, Exeter Associates, Inc.

NAE's witness was Lisa Pishevar, General Manager, NAE.

CNEG's witnesses were John M. Oroni, Regional Sales Director, CNEG; and Lisa A. Rozumialski, Manager of Gas Operations, CNEG.

ELPC's witness was Charles Kubert, Senior Environmental Business Specialist, ELPC.

IIEC, VES and CNEG filed joint testimony. Their witness was Dr. Alan Rosenberg, Consultant, Brubaker & Associates.

Multiut's witnesses were Nachshon Draiman, President, Multiut; Raquel Lavenda, Manager of Operations, Multiut.

RGS' witness was James L. Crist, President, Lumen Group

VES' witness was Neil Anderson, Partner, VES.

UWUA's witness was James Gennett, President, Local Union No. 18007.

Testimony, Motions, and Rulings

On March 9, 2007, the Utilities filed their respective direct testimony with their respective Part 285 filings. North Shore filed direct testimony of each of the Utilities' witnesses listed above, except for Mr. Hoover, Mr. Phillips, Mr. Puracchio, Mr. Schott, and Mr. Volante. Peoples Gas filed direct testimony of each of the Utilities' witnesses listed above, except for Mr. Hoover and Mr. Volante. Mr. Phillips submitted only direct testimony, he did not later submit rebuttal or surrebuttal testimony. Mr. Hoover submitted only rebuttal and surrebuttal testimony. Mr. Volante submitted only surrebuttal testimony, which he did in a panel with Mr. Hoover.

On April 24, 2007, North Shore and Peoples Gas each filed a parallel Motion for Entry of an Order Regarding Case Management Plan and Schedule (the "Case Management Motion") requesting a ruling establishing a case management plan and schedule for the applicable Docket. Also on April 24, 2007, North Shore and Peoples Gas each filed a parallel Motion for Entry of a Protective Order (the "Protective Order Motion"), requesting that a protective order be entered pursuant to 220 ILCS 5/4-404 and 83 Ill. Admin. Code §§ 200.190 and 200.430 in the applicable Docket.

On April 24, 2007, the AG filed parallel Motions for Establishment of a Case Management Plan and Schedule requesting a ruling approving the AG's case management plan and schedule and denying North Shore's and Peoples Gas' Case Management Motion.

On April 25, and April 27, 2007 a Prehearing Conference was held, as stated above. On April 27, 2007, the ALJs issued a Notice of Administrative Law Judges' Ruling adopting a schedule for these now-consolidated Dockets.

On April 30, 2007, GCI filed a Response to Peoples Gas' and North Shore's Proposed Order Regarding Protection of Confidential and Confidential and Proprietary Information and Proposed Case Management Order.

On May 3, 2007, Peoples Gas filed a Reply in Support of their Motions for Entry of a Protective Order.

On May 9, 2007, the ALJs issued an Order For a Case Management Plan and Schedule, in response to North Shore's and Peoples Gas' Case Management Motion, for these Dockets. Also on May 9, 2007, the ALJs issued a ruling in response to North Shore's Peoples Gas' Protective Order Motion, approving and issuing a protective order for these Dockets.

On June 5, 2007, Peoples Gas filed errata to its direct testimony and Part 285 submission.

On June 29, 2007, Staff and the Intervenors filed their respective direct testimony, except that Mr. Mierzwa did not submit direct testimony, RGS filed its direct testimony on July 2, 2007, and GCI filed its direct testimony on July 3, 2007.

On July 24, 2007, Staff filed a Motion for Leave to File Supplemental Direct Testimony Instantly for Staff witness Daniel Kahle.

On July 27, 2007, North Shore and Peoples Gas filed a Response to Staff's Motion for Leave to File Supplemental Direct Testimony Instanter indicating that the Companies did not object to the supplemental testimony of Staff witness Kahle, provided that the schedule for filing of any other testimony by Staff or interveners is not extended.

On July 27, the Utilities filed rebuttal testimony of their witnesses as indicated above.

On July 30, 2007, the ALJs granted Staff's Motion for Leave to File Supplemental Direct Testimony Instanter.

On August 10, 2007, the Utilities filed supplemental rebuttal testimony of Mr. Fiorella to the supplemental direct testimony of Mr. Kahle.

On August 13, 2007 the ALJs issued a ruling amending the case management order and confirming the date and time for the evidentiary hearing.

On August 21, 2007, Staff and the Intervenors filed their respective rebuttal testimony, except that of Staff witness Dr. Rearden.

On August 22, 2007 Staff filed a Motion for Leave to File Rebuttal Testimony of Staff Witness David Rearden Instanter.

On August 23, 2007, the ALJs issued a ruling granting Staff's Motion for Leave to File Rebuttal Testimony of Staff Witness David Rearden Instanter.

On August 24, 2007, the Utilities filed a Motion to Strike Portions of GCI Witness William L. Glahn's Direct and Rebuttal Testimony relating to inadmissible testimony relating to climate science.

On August 30, 2007, GCI filed a response to the Motion to Strike Portions of GCI Witness William L. Glahn's Direct and Rebuttal Testimony.

On August 31, 2007, GCI filed an errata to their August 30th response.

On September 4, 2007, the Utilities filed a Reply in Support of its Motion to Strike Portions of GCI Witness William L. Glahn's Direct and Rebuttal Testimony relating to inadmissible testimony relating to climate science.

On September 5, 2007, the ALJs issued a ruling granting in part and denying in part the Utilities' Motion to Strike Portions of GCI Witness William L. Glahn's Direct and Rebuttal Testimony.

On September 5, 2007 the Utilities filed surrebuttal testimony of their witnesses as indicated above.

On September 7, 2007, the AG filed a Motion to Strike Portions of the Surrebuttal Testimony of James F. Schott. Also on September 7, 2007, the AG filed a Motion to Strike Portions of the Surrebuttal Testimony of Dr. Eugene S. Takle.

On September 7, 2007, the Utilities filed a Second Errata, identifying corrections to attachments to their witness Mr. Amen's direct testimony.

On September 10, 2007, the Utilities filed a Third Errata, identifying corrections to an attachment to the surrebuttal testimony of their witness Mr. Zack and deleting certain inadvertently repeated lines in the direct testimony of their witness Ms. Grace.

On September 10, 2007, Peoples Gas filed a response to the AG's Motion to Strike Portions of the Surrebuttal Testimony of James F. Schott. Also on September 10, 2007, North Shore and Peoples Gas filed a response to the AG's Motion to Strike Portions of the Surrebuttal Testimony of Dr. Eugene S. Takle.

On September 11, 2007, the AG filed a Reply to Peoples Gas' Response to the AG's Motion to Strike Portions of the Surrebuttal Testimony of James Schott. Also on September 11th, the AG filed a Reply to Peoples Gas' Response to the AG's Motion to Strike Portions of the Surrebuttal Testimony of Dr. Eugene S. Takle.

On September 11, 2007, North Shore and Peoples Gas filed a Fourth Errata containing two corrections to its witness Ms. Grace's direct testimony and deleting a cross-reference in their witness Mr. Schott's surrebuttal testimony.

During the evidentiary hearing, various witnesses on behalf of Staff and various parties submitted oral errata to their pre-filed testimony, as reflected in the transcripts. On September 5, 2007, the ALJs granted in part and denied in part the Utilities' motion to strike portions of the direct and rebuttal testimony of Mr. Glahn.

On September 17, 2007, the ALJ's granted the AG's motion to strike a portion of the surrebuttal testimony of Mr. Schott.

On September 18, 2007, Peoples Gas submitted Second Revised Surrebuttal Testimony of Mr. Schott, reflecting the ALJs' ruling on the related motion to strike.

On September 18, 2007, NAE filed a Motion to Correct Transcript.

On September 19, 2007, the Utilities filed a Proposed Stipulation of Peoples Gas, North Shore, CUB, and the City regarding testimony of Ms. Kallas.

On September 20, 2007, the ALJs directed that Staff and the parties file revised versions of the affected pre-filed testimony reflecting the oral errata presented at the evidentiary hearing. Staff and the parties subsequently complied, as applicable.

On September 25, 2007, the ALJs issued a ruling approving the Proposed Stipulation of Peoples Gas, North Shore, CUB and City.

On September 27, 2007, UWUA filed a Motion to Correct Transcripts.

On October 11, 2007, Staff filed a First Motion to Correct Transcripts.

On October 12, 2007, the Utilities, Staff, the AG, CNEG, CUB, the City, ELPC, IIEC, Multiut, NAE, RGS, VES, and UWUA all filed their respective Initial Briefs.

On October 15, 16, 17, 18, 19, and 22, 2007, the Utilities filed motions to correct the transcripts.

On October 16, 2007, the Utilities filed a Motion to Correct their Initial Post-Hearing Brief (to remove a superfluous paragraph). Also on October 16, 2007, Staff filed a Corrected Initial Brief (to correct the Appendices thereto).

On October 23, 2007, the Utilities and ____ submitted their respective post-hearing Reply Briefs.

On October 23, 2007, the Utilities and ____ submitted their respective draft Proposed Orders.

On ____, the ALJs ruled on the various motions to correct the transcripts as follows:
_____.

On ____, the ALJs issued their Proposed Order.

On ____, ____ submitted their respective Briefs on Exceptions.

On ____, ____ submitted their respective Reply Briefs on Exceptions.

I. INTRODUCTION

A. Summary

1. Legal Standards

The Commission, in these proceedings, is presented with the Utilities' first general rate cases since 1995. The Commission, in addressing the issues raised in these consolidated Dockets and in considering the extensive evidentiary record that has been made herein, is governed by a number of basic legal principles.

The Commission, in contested rate case proceedings, must establish rates that are just and reasonable for customers, the Utilities, and the Utilities' 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).

A public utility has a constitutional right to a return that is "reasonably sufficient to assure confidence in the financial soundness of the utility and [is] adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield Waterworks & Imp. Co. v. Public Service Comm'n*, 262 U.S. 679, 693 (1923). The authorized return on equity "should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the

enterprise, so as to maintain its credit and to attract capital.” *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

Illinois law is consistent. The Commission “fully embraces the principles set forth” in the *Bluefield* and *Hope* cases. *In re Consumers Ill. Water Co.*, ICC Docket No. 03-0403, p. 41 (Order April 13, 2004).

The Commission’s final Order in these consolidated 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. *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).

2. Overview

As indicated above, these proceedings were initiated by the filing of the Utilities’ first general rate cases since 1995. Peoples Gas proposed four new “tracker” Riders and North Shore proposed three such riders as well as revised tariffs. The Commission has been presented with an extensive evidentiary record. Many issues are uncontested. The Commission rules on the uncontested and contested issues as stated in the remainder of this Order.

B. Nature of Operations

1. Peoples Gas

Peoples Gas is a local distribution company engaged in the business of transporting, purchasing, storing, distributing, and selling natural gas at retail to approximately 840,000 residential, commercial, and industrial customers within the City of Chicago. Borgard Dir., Peoples Gas Ex. LTB-1.0 REV, 4:90 - 5:92; Doerk Dir., Peoples Gas Ex. ED-1.0, 3:53-54. This service territory covers an area of about 228 square miles and has a population of approximately three million people. Borgard Dir., Peoples Gas Ex. LTB-1.0 REV, 5:92-93. Peoples Gas employs approximately 1,540 people, virtually all within the City of Chicago. *Id.* at 5:93-94. Peoples Gas is a wholly owned subsidiary of Peoples Energy Corporation, which in turn is a wholly owned subsidiary of Integrys Energy Group, Inc. (“Integrys”) *Id.* at 5:95-96.

Peoples Gas’ distribution system consists of approximately 4,025 miles of gas distribution mains. Doerk Dir., Peoples Gas Ex. ED-1.0, 3:54-56. It owns approximately 425 miles of gas transmission lines. *Id.* at 3:56. The distribution system is most commonly operated at a pressure range of 0.25 to 25 pounds per square inch, while the transmission system operates at pressures up to 300 pounds per square inch or more. *Id.* at 3:56-59. Peoples Gas also owns a storage field, Manlove Field. *Id.* at 3:59-60.

The physical configuration of Peoples Gas’ system is a dispersed/multiple city gate, integrated transmission/distribution and multi pressure-backed system. Doerk Dir., Peoples Gas Ex. ED-1.0, 3:63-64. It is designed to provide gas service to all customers entitled to be attached to the system, to deliver volumes of natural gas to all sales and transportation customers, and to meet the aggregate peak design day capacity requirements of all customers entitled to service on the peak day. *Id.* at 4:66-69. According to Peoples Gas, a gas utility system sized only to

accommodate average gas demands would not be able to meet system peak demands. *Id.* at 4:69-71.

2. North Shore

North Shore is a local distribution company engaged in the business of transporting, purchasing, storing, distributing and selling natural gas at retail to approximately 158,000 residential, commercial, and industrial customers within fifty-four communities in Lake and Cook Counties, Illinois. Borgard Dir., North Shore Ex. LTB-1.0 REV, 4:87-90; Doerk Dir., North Shore Ex. ED-1.0, 3:47-49. North Shore employs approximately 200 people, while sharing many administrative facilities owned by Peoples Gas. Borgard Dir., North Shore Ex. LTB-1.0 REV, 4:90-4:92. North Shore is a wholly owned subsidiary of Peoples Energy Corporation, which in turn is a wholly owned subsidiary of Integrys. *Id.* at 5:92-94.

North Shore's distribution system consists of approximately 2,270 miles of gas distribution mains. Doerk Dir., North Shore Ex. ED-1.0, 3:49-50. North Shore owns approximately 95 miles of gas transmission lines. *Id.* at 3:50-51. Its distribution system is most commonly operated at a pressure of 45 pounds per square inch, while the transmission system operates at a pressure of 250 pounds per square inch. *Id.* at 3:51-53. While North Shore does not own any storage fields, it does purchase storage services from Peoples Gas, pursuant to a storage services agreement, approved by the Commission, and from two interstate pipelines. *Id.* at 3:53-59. In addition, North Shore owns a liquid propane production facility used for peaking purposes. *Id.* at 3:59-60.

The physical configuration of North Shore's system is a dispersed/multiple city-gate, integrated transmission/distribution and multi pressure-based system. Doerk Dir., North Shore Ex. ED-1.0, 3:62-63. It is designed to provide gas service to all customers entitled to be attached to the system, to deliver volumes of natural gas to all sales and transportation customers, and to meet the aggregate peak design day capacity requirements of all customers entitled to service on the peak day. *Id.* at 4:65-68. According to North Shore, a gas utility system sized only to accommodate average gas demands would not be able to meet system peak demands. *Id.* at 4:68-70.

C. Test Year

The Utilities each proposed their fiscal year 2006, i.e., the twelve months ending September 30, 2006, as their test year. Fiorella Dir., Peoples Gas Ex. SF-1.0, 5:98-99; Fiorella Dir., North Shore Ex. SF-1.0, 5:102-103. The 2006 test year data were based on the Utilities' actual 2006 revenues, expenses, and rate base items, subject to appropriate adjustments. Fiorella Dir., Peoples Gas Ex. SF-1.0, 6:118-120, 7:140-141; Fiorella Dir., North Shore Ex. SF-1.0, 6:122-124, 7:144-145. No party contested the proposed test year, which was ordered by the Commission in *In re WPS Resources Corp., et al.*, ICC Docket No. 06-0540, Appendix, Condition of Approval No. 13 (Order Feb. 7, 2007).

II. RATE BASE

A. Overview

1. Peoples Gas

In its direct case, Peoples Gas proposed a rate base of \$1,308,007,000, consisting of \$1,500,600,000 of net plant (\$2,434,914,000 of gross plant less \$934,314,000 of Accumulated Provision for Depreciation and Amortization (“Depreciation Reserve”)), plus \$126,359,000 for three items increasing rate base, less \$318,952,000 for items reducing rate base. *E.g.*, PGL Ex. SF-1.1 at Sched. B-1.

Peoples Gas, in its rebuttal and surrebuttal testimony, agreed with or, in order to narrow the issues, accepted a number of rate base adjustments proposed by Staff and GCI, resulting in Peoples Gas’ final rate base figure of \$1,289,531,000. That figure consists of:

- \$1,495,173,000 of net plant (\$2,429,392,000 of Gross Utility Plant less \$934,219,000 of Accumulated Provision for Depreciation and Amortization or “Depreciation Reserve”);
- \$126,359,000 for three additional items, i.e., Gas in Storage, Materials and Supplies, and Cash Working Capital; and
- \$332,001,000 for reductions, mainly Accumulated Deferred Income Taxes.

E.g., NS-PGL Ex. SF-4.1P.

Peoples Gas’ final proposed rate base of \$1,289,531,000 is approved by the Commission. Peoples Gas’ final revised rate base figure appropriately and correctly reflects its prudent, reasonable cost, and used and useful investments made in its systems in order to serve its customers. The uncontested and contested issues relating to its rate base are discussed in the following subsections (B) through (F) of this Section II of this Order.

2. North Shore

In its direct case, North Shore proposed a rate base of \$197,107,000, consisting of \$231,444,000 of net plant (\$380,087,000 of gross plant less \$148,643,000 of Depreciation Reserve), plus \$10,922,000 for three items increasing rate base, less \$45,259,000 for items reducing rate base. *E.g.*, NS Ex. SF-1.1 at Sched. B-1.

North Shore, in its rebuttal and surrebuttal testimony, also agreed with or, in order to narrow the issues, accepted a number of rate base adjustments proposed by Staff and GCI, resulting in North Shore’s final rate base figure of \$193,577,000. That figure consists of:

- \$229,779,000 of net plant (\$378,350,000 of gross plant less \$148,571,000 of Depreciation Reserve);

- \$10,922,000 for three additional items, i.e., Gas in Storage, Materials and Supplies, and Cash Working Capital; and
- \$47,124,000 for reductions, mainly Accumulated Deferred Income Taxes.

E.g., NS-PGL Ex. SF-4.1N.

North Shore's final proposed rate base of \$193,577,000 is approved by the Commission. North Shore's final revised rate base figure appropriately and correctly reflects its prudent, reasonable cost, and used and useful investments made in its system in order to serve its customers. The uncontested and contested issues relating to its rate base are discussed in the following subsections (B) through (F) of this Section II of this Order.

B. Uncontested Issues

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

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities agreed to Staff's proposal that the Commission's final order include an original cost determination pursuant to 83 Ill. Adm. Code 510 and Appendix A thereto regarding each of the utilities' Gross Utility Plant balances as of September 30, 2006 (the end of the test year). NS-PGL Ex. LMK-3.0, 5:109 – 6:114. The Utilities further agreed with Staff's recommendation that Peoples Gas' original cost of plant of \$2,327,999,000 and North Shore's original cost of plant of \$369,442,000 as reflected on the Utilities' Schedules B-1, line 1, column [D], be unconditionally approved.

Commission Analysis and Conclusion

Staff proposed that the final order include an original cost determination pursuant to 83 Ill. Adm. Code 510 and Appendix A thereto as follows:

It is further ordered that the \$2,327,999,000 original cost for Peoples Gas and the \$369,442,000 original cost for North Shore of plant at September 30, 2006, as reflected on the Companies' Schedules B-1, Line 1, column D, is unconditionally approved as the original cost of plant.

The Commission finds that this proposed language is reasonable and appropriate, and, therefore, approves it.

2. Pro Forma Capital Additions

North Shore / Peoples Gas

Peoples Gas and North Shore originally proposed *pro forma* adjustments, for post-test year capital additions reasonably expected to be placed in service no later than February 2008, in the gross amounts of \$104,524,000 (net \$95,464,000 after the applicable subtractions for Depreciation Reserve and ADIT) and \$10,645,000 (net \$9,899,000 after the applicable subtractions for Depreciation Reserve and ADIT), respectively. *E.g.*, PGL Ex. SF-1.0, 18:384 – 19:402; PGL Ex. SF-1.1, Scheds. B-1, column [E], B-2, column [B], and B-2.1; NS Ex. SF-1.0, 17:373 – 18:391; NS Ex. SF-1.1, Scheds. B-1, column [E], B-2, column [B], and B-2.1.

Other Parties

[Insert]

North Shore / Peoples Gas Response

After GCI in its direct testimony proposed reductions to the Utilities' *pro forma* adjustments for post-test year capital additions, the Companies provided updated data regarding their capital expenditures in their rebuttal testimony. NS-PGL Ex. SF-2.0, 8:168 – 9:194. Staff and GCI in their rebuttal then proposed revised adjustments.

The Utilities in their surrebuttal testimony stated that they do not contest Staff's final revised figures for *pro forma* adjustments for capital additions, which consist of the amounts Staff's witness suggested in his rebuttal testimony (a reduction of \$19,232,000 for Peoples Gas and \$1,734,000 for North Shore (gross amounts)) plus an additional \$10,405,000 of Peoples Gas' cushion gas additions he supported in a subsequent data request response (in evidence), i.e., a net \$95,697,000 (\$104,524,000 less \$19,232,000 plus \$10,405,000) as to Peoples Gas and a net \$8,911,000 (\$10,645,000 less \$1,734,000) as to North Shore. Kahle Corr. Reb., Staff Ex. 15.0, 14:291 – 16:335; NS-PGL Ex. SF-4.0, 5:108 – 6:124; NS-PGL Ex. SF-4.2P, column [D]; NS-PGL Ex. SF-4.2N, column [D].

Commission Analysis and Conclusion

The Commission finds the Staff final revised proposal that the Utilities' *pro forma* adjustments for capital additions be a net \$95,697,000 as to Peoples Gas and a net \$8,911,000 as to North Shore is not opposed by any party, is reasonable and appropriate, and, therefore, approves it.

3. Capitalized Lobbying Expenses

See Section III(B)(5)(d) of this Order, *infra*.

4. Capitalized City of Chicago Resurfacing Costs (PGL)

See Section III(B)(2)(c) of this Order, *infra*.

5. ADIT - Gas Cost Reconciliation

Other Parties

[Insert]

North Shore / Peoples Gas Response

North Shore and Peoples Gas do not contest GCI's proposed adjustments to ADIT related to gas cost reconciliation. NS-PGL Ex. SF-2.0, 4:82-90, 5:109; PGL Ex. SF-2.2P, column [E]; NS Ex. SF-2.2N, column [D]. The proposed adjustments increase ADIT, and thus reduce rate base, by the amounts of \$5,748,000 as to Peoples Gas and \$1,142,000 as to North Shore. GCI Ex. 2.0, 14:295-312, 16:350 – 17:379 and Sched. B-2.

Commission Analysis and Conclusion

The Commission finds that GCI's proposed adjustments to ADIT related to gas cost reconciliation as revised, which reduce Peoples Gas' rate base by \$5,748,000 and North Shore's rate base by \$1,142,000, are not contested and reasonable and, therefore, approves them.

6. [ADIT -] AMT - Gas Charge Settlement

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest GCI's proposed adjustments to Alternative Minimum Taxes ("AMT"), and thus to ADIT. NS-PGL Ex. SF-2.0, 4:82-90, 5:110; PGL Ex. SF-2.2P, column [F]; NS Ex. SF-2.2N, column [E]. GCI witness Mr. Effron's proposed adjustments to AMT, and thus to ADIT, which are related to the gas charge settlement, increase ADIT, and thus reduce rate base, by \$7,820,000 as to Peoples Gas and \$773,000 as to North Shore. GCI Ex. 2.0, 14:298-312, 14:314 – 16:348 and Sched. B-2.

Commission Analysis and Conclusion

The Commission finds that GCI's proposed adjustments to Alternative Minimum Taxes as revised, which increase ADIT and thus reduce Peoples Gas' rate base by \$7,820,000 and increase ADIT and thus reduce North Shore's rate base by \$773,000, are not contested and are reasonable and, therefore, approves them.

C. Plant

1. Capitalized Incentive Compensation

See Section III(C)(3)(b) of this Order, below.

2. Hub Services (PGL) (Addressed in Section V, below)

See Section V of this Order, below.

D. Reserve for Accumulated Depreciation and Amortization

1. GCI's Proposed Adjustments

North Shore and Peoples Gas

Peoples Gas and North Shore correctly calculated the amounts for their Depreciation Reserves that should be subtracted from gross plant when calculating their rate bases. They properly started with the Depreciation Reserve amounts as of the end of the test year, fiscal year 2006, i.e., as of September 30, 2006, and then made the correct adjustments needed to reflect the impacts of their proposed adjustments to plant, including their *pro forma* adjustments for post-test year capital additions. Fiorella Dir., PGL Ex. SF-1.0, 9:192-197, 14:306 – 15:321, 18:377-394; PGL Ex. SF-1.1, Sched. B-1, line 2, Sched. B-2, column [B], Sched. B-2.1, Sched. B-6; Fiorella Dir., NS Ex. SF-1.0, 9:196-201, 14:304 – 15:318, 17:366 – 18:383; NS Ex. SF-1.1, Sched. B-1, line 2, Sched. B-2, column [B], Sched. B-2.1, Sched. B-6.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Commission should reject the adjustments to the Depreciation Reserves proposed by GCI witness Mr. Effron. Effron Dir., GCI Ex. 2.0, 5:96 – 8:176, 10:210 – 12:252; Effron Reb., GCI Ex. 5.0, 3:62 – 6:142. While he asserts that his proposed adjustments somehow are justified by the Utilities' proposed *pro forma* adjustments for post-test year capital additions, he does not and cannot claim that the Utilities have incorrectly calculated the impacts of those adjustments on the Depreciation Reserves. Rather, he inappropriately and incorrectly seeks to use those adjustments as an excuse to add another year of depreciation to the Depreciation Reserve related to existing plant as of the test year, not to the depreciation applicable to the *pro forma* adjustments for post-test year capital additions for which the Utilities already correctly have accounted. Fiorella Reb., NS-PGL Ex. SF-2.0, 9:196 – 11:227; Fiorella Sur., NS-PGL Ex. SF-4.0, 8:163 – 9:187. Staff's witness agrees with the Utilities that Mr. Effron's proposed adjustments are inappropriate and incorrect for that reason, i.e., the proposed adjustments switch test years for the Depreciation Reserve values for existing plant as of the test year. Kahle Corr. Reb., Staff Ex. 15.0, 17:346-359.

Mr. Effron's proposal also is unfair, because it does not move forward to a 2007 value, rather than a test year value, other items which would increase the Utilities' revenue requirements. Fiorella Reb., NS-PGL Ex. SF-2.0, 10:214-222. Mr. Effron's rejoinders, that the ADIT value likely would increase in 2007 and "there is no reason to believe that the other components [of rate base besides net plant and ADIT] would change materially from the test year to 2007" (Effron Reb., GCI Ex. 5.0, 3:78 - 4:83), miss the point about inappropriately and unfairly deviating from test year principles.

Mr. Effron's proposed adjustment, which is based on adding another year of depreciation expense to the Depreciation Reserves, also should be rejected because it fails to meet the criteria for *pro forma* adjustments. The proposal does not meet the "known and measurable" criteria of 83 Ill. Adm. Code § 287.40, as Staff's witness also pointed out. Kahle Corr. Reb., Staff Ex. 15.0, 17:355-357. The proposal also is based on attrition, contrary to the attrition and inflation language of 83 Ill. Adm. Code § 287.40, which Mr. Effron himself invoked when opposing the Utilities' proposed *pro forma* adjustments for inflation in non-payroll expenses, which the Utilities later withdrew. Effron Dir., GCI Ex. 2.0, 26:586 – 27:595 (mistakenly citing the predecessor provision of 83 Ill. Adm. Code § 287.40 in Part 285 of the Commission's rules prior to the 2003 amendments).

The Commission rejected adjustments like those that Mr. Effron proposes in *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597 (Order, July 26, 2006), at pp. 12-15, and *In re Commonwealth Edison Co.*, ICC Docket No. 01-0423 (Interim Order April 1, 2002), at pp. 41-44 (carried forward to final Order of March 28, 2003)). While Mr. Effron claimed that his proposal finds support in other Commission Orders, the facts of the instant proceeding are like those of the two cases cited above, not like the ones that Mr. Effron cites where the Utilities had no increase in net plant, as discussed in detail in the Utilities' Reply Brief. *See also* NS-PGL Init. Br. at 20; Fiorella Reb., NS-PGL Ex. SF-2.0, 10:220-227; Fiorella Sur., NS-PGL Ex. 4.0, 8:163-182.

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 in service balances have not been decreasing over time, they have been increasing. Schedules B-5 and B-6 in PGL Ex. SF-1.1 and NS. Ex. SF-1.1 and Companies witness Mr. Fiorella's hearing testimony (Tr. 117:2-11, 118:13-14) provide uncontradicted evidence of the Utilities' increasing net plant balances..

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 Peoples Gas and \$9 million for North Shore, reflecting the correct deductions for the Depreciation Reserves and ADIT). *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), although GCI seeks to use them as a pretext for GCIs' proposed adjustments to the Depreciation Reserves. Peoples Gas and North Shore correctly rejected the proposal of GCI witness Mr. Effron to add another year of depreciation to the Depreciation Reserves, which proposal is applicable to existing plant, not related to the plant involved in the *pro forma* adjustments. Staff's witness agreed with the Companies' witness Mr.

Fiorella that Mr. Effron's proposed adjustments based on, in effect, changing the test year for existing plant, were inappropriate and incorrect, as noted above.

The cases that are on point 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 briefs. In those cases, the Commission rejected Mr. Effron's proposed adjustments to Depreciation Reserves that are virtually the same as Mr. Effron proposes in this proceeding, in factual situations that are similar to the factual situations of Peoples Gas and North Shore, not different as in the cases cited by the AG and City-CUB.

In fact, in ICC Docket No. 05-0597, the AG unsuccessfully argued that decisions in the same IP, AmerenCIPS, AmerenCILCO, and AmerenUE cases, were relevant to the ComEd case. 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 the 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 test year into the future for accumulated depreciation. The Commission rejects the AG's proposed adjustment.

Order in ICC Docket No. 05-0597 at p. 15.

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.

Based on the foregoing, the Companies and Staff have demonstrated that GCI's proposed adjustments to the Depreciation Reserve are not warranted, violate test year rate making principles, and are not appropriate under the *pro forma* adjustments rule, 83 Ill Admin. Code § 287.40, and thus, they should be rejected.

While the Commission should reject Mr. Effron's proposed adjustments to the Depreciation Reserves in their entirety, it also should be noted that his proposal miscalculates the Utilities' costs of removal, because it does not comport with how the Utilities account for these

costs. He erroneously proposes to deduct amounts for costs of removal from the Depreciation Reserves when, instead, they should be added to depreciation expenses, which would increase the revenue requirements, and he also has his figures wrong. Fiorella Reb., NS-PGL Ex. SF-2.0, 11:228 – 12:249; Fiorella Sur., NS-PGL Ex. SF-4.0, 9:188 – 10:209 (also noting that the Commission has accepted the Utilities’ accounting for costs of removal over several decades).

Commission Analysis and Conclusion

The Commission does not adopt GCI’s proposed adjustments to Peoples Gas’ and North Shore’s Depreciation Reserves. The Companies correctly calculated their Depreciation Reserves as of the end of the test year and the related impacts of their proposed adjustments, including the now uncontested *pro forma* adjustments for post-test year capital additions discussed in Section II(B)(2) of this Order.

GCI’s proposed adjustments are not warranted based on those *pro forma* adjustments or otherwise. GCI’s proposed adjustments would inappropriately move one element of rate base forward one year. Given the facts of the instant rate cases, that is not warranted. The circumstances here are similar to those in the Orders cited by the Companies, not those cited by GCI. Moreover, Staff and the Utilities are correct in stating that adoption of GCI’s proposed adjustments would be inconsistent with test year principles and with the language regarding known and measurable adjustments and adjustments based on attrition in the Commission’s *pro forma* adjustments rule, 83 Ill. Adm. Code § 287.40.

2. Derivative Adjustments

Other than GCI’s proposed adjustments to the Utilities’ Depreciation Reserves, discussed in Section II(D)(1) of this Order, Staff and intervenors have not proposed any independent adjustments to the Depreciation Reserves as such. Accordingly, the Commission, as to the Depreciation Reserves, need only make derivative calculations reflecting the approved adjustments to plant in rate base.

E. Cash Working Capital

North Shore / Peoples Gas

Cash working capital (“CWC”) is the amount of cash a company requires to finance its day-to-day operations. Adams Dir., NS Ex. MJA-1.0, 3:54-56; Adams Dir., PGL Ex. MJA-1.0, 3:54-56. The Companies calculated their CWC requirements using the net lag methodology. Adams Dir., NS Ex. MJA-1.0, 3:63-4:65; Adams Dir., PGL Ex. MJA-1.0, 3:63-65. Specifically, the Companies calculated their revenue lags, *i.e.*, the number of days between the dates customers receive service from the Companies and the dates they pay for that service, and expense lead times, *i.e.*, the number of days between the Companies’ receipt of goods and services and the dates the Companies pay for them. Adams Dir., NS Ex. MJA-1.0, 4:65-68; Adams Dir., PGL Ex. MJA-1.0, 3:65-4:68. Then, the Companies netted their lag and lead calculations and divided the net lag by 365 days to determine a daily CWC factor and multiplied their yearly cash expenses by that CWC factor to determine the amount of cash they require to

finance their daily operations. Adams Dir., NS Ex. MJA-1.0, 4:68-72; Adams Dir., PGL Ex. MJA-1.0, 4:68-72.

The Companies explained that they utilized the net lag methodology to calculate their CWC requirements because the approach is easier to use than other techniques and it is the methodology preferred in a number of other jurisdictions. Adams Dir., NS Ex. MJA-1.0, 17:368-18:371; Adams Dir., PGL Ex. MJA-1.0, 18:391-19:394; ; Adams Surrebut., NS-PGL Ex. MJA 3.0, 4:75-81. Further, this Commission has accepted the net lag approach in prior proceedings. Adams Surrebut., NS-PGL Ex. MJA 3.0, 8:171-9:176. The Companies further explained (and demonstrated) that a competing methodology, known as the gross lag methodology, will produce essentially the same results as the net lag methodology if the gross lag methodology is properly applied. Adams Dir., NS Ex. MJA-1.0, 18:389-19:394; Adams Dir., PGL Ex. MJA-1.0, 19:412-20:417.

Staff

[Insert]

North Shore / Peoples Gas Response

After reasserting the desirability of using the net lag methodology to calculate their CWC requirements, the Companies agreed to adjust their position and accede to Staff's proposal to utilize the gross lag methodology since the two methodologies, when properly applied, produce essentially equivalent results. Adams Reb., NS-PGL Ex. MJA-2.0, 4:72-77; Adams Sur., NS-PGL Ex. MJA-3.0, 4:76-84 and 6:116-18; Adams, Tr. at 283:9-12. However, because of errors in Staff's CWC analyses, the Companies opposed the CWC requirements advocated by Staff and argued that the Commission should authorize them to recalculate their CWC requirements using the gross lag methodology, making all required adjustments, and the revenue and expense levels approved in this consolidated docket. Adams Reb., NS-PGL Ex. MJA-2.0, 2:25-31, 3:48-50, 5:91-107 and 10:208-15; Adams Sur., NS-PGL Ex. MJA-3.0, 6:120-22.

Specifically, the Companies argued that they should be authorized to exclude all capitalized expenditures from their analyses because CWC calculations only concern operating expenses and operating revenues, which must be balanced to accurately determine a company's CWC requirement. Adams Reb., NS-PGL Ex. MJA-2.0, 5:99-104, 7:146-49, 8:159-68; Adams Sur., NS-PGL Ex. MJA-3.0, 11:223-32, 13:253-62 and 270-74, 14:289-96. Thus, including any portion of capitalized expenditures in the calculations would corrupt the results. The Companies also argued that including capitalized expenditures in CWC calculations would distort the calculation of rates of return, explaining that capitalized expenditures are directly included in rate base and should not be included a second time as part of a CWC requirement. Adams Reb., NS-PGL Ex. MJA-2.0, 7:148-49 and 9:182-84; Adams Sur., NS-PGL Ex. MJA-3.0, 13:255-56; Adams, Tr. at 301:5-10; *see* Kahle Corr. Supp. Dir., Staff Ex. 3.0, 4:64-67; Kahle Corr. Reb., Staff Ex. 15.0, 10:199-200. Further, the Companies argued that the Commission, in Illinois Power Company's petition for approval of Delivery Services Implementation Plan and Delivery Services Tariffs, Docket Nos. 99-0120/99-0134 (Cons.) (August 25, 1999), pp. 63-64, previously has recognized that excluding capitalized expenditures from CWC avoids the possibility of improper double accounting of such expenses. Kahle, Corr. Supp. Dir., Staff Ex. 3.0, 4:76-81; Kahle, Tr. at 1160:10-21. Accordingly, the Companies urged the Commission to reject Staff's

unjustified contention that the capitalized portion of payroll-related expenditures should be included in their CWC calculations. Adams Reb., NS-PGL Ex. MJA-2.0, 7:146-49, 8: 8:159-61 and 171-75; Adams Sur., NS-PGL Ex. MJA-3.0, 13:253-56 and 265-69; Kahle, Tr. at 1156:8-22.

With respect to Taxes Other Than Income Taxes, the Companies argued that they should be permitted to treat all such taxes, including real estate taxes, in a uniform manner. *See* Adams Reb., NS-PGL Ex. MJA-2.0, 11:223-29; Adams Sur., NS-PGL Ex. MJA-3.0, 18:365-70, 19:398-401; Adams, Tr. at 302:20-303-18. In opposition to Staff's contention that real estate taxes should be treated independently of other non-income taxes, the Companies explained that doing so would give real estate taxes a disproportionate effect on the calculations. Adams Reb., NS-PGL Ex. MJA-2.0, 11:230-37; Adams Sur., NS-PGL Ex. MJA-3.0, 19:387-97; Adams, Tr. at 302:2-303:18 and 305:3-8. The Companies also noted that Staff's purported justification for treating real estate taxes differently than other Taxes Other Than Income Taxes failed. The relatively long lead time associated with real estate taxes, which Staff relied on to support separate treatment for real estate taxes, is no different than the relatively short lead time for FICA taxes, which Staff did not assert should be treated differently than other Taxes Other Than Income Taxes. *See* Adams, Tr. at 303:19-304:8; Kahle, Tr. at 1168:7-16.

The Companies argued that because they are not responsible for paying pass through taxes, the dollar expense associated with pass through taxes should not be included in their CWC calculations. *See* Adams, Tr. 290:10-291:1 and 291:17-21; Kahle, Corr. Reb., Staff Ex. 15.0, 11:230-33; Kahle, Tr. at 1165:5-15. However, because of the difference between the dates pass through taxes are assessed and the dates they are paid, such taxes impact their cash flow and therefore should be considered when calculating the expense lead time associated with Taxes Other Than Income Taxes. Adams Sur., NS-PGL Ex. MJA-3.0, 20:413-17; Adams, Tr. at 290:7-15; *see* Kahle, Tr. at 1164:9-15.

Finally, the Companies argued, and Staff subsequently agreed, that uncollectibles should be excluded from both revenues and expenses and that the determination of North Shore's CWC requirement should incorporate North Shore's fuel-related lead time rather than the lead time calculated for Peoples Gas. Adams Reb., NS-PGL Ex. MJA-2.0, 12:248-260; Kahle Corr. Reb., Staff Ex. 15.0, 6:112-115, 13:270-274.

Commission Analysis and Conclusion

Cash working capital is the amount of cash a company requires to meet its daily cash operating expenses. The Companies agree that their CWC requirements can be accurately determined using the gross lag methodology as proposed by the Utilities. Accordingly, the Commission orders the Companies to recalculate their CWC requirements utilizing the gross lag methodology and the revenue and expense levels approved in this consolidated proceeding.

It is undisputed that uncollectibles are properly excluded from both revenues and expenses and that North Shore's fuel-related expense lead time should be used to calculate North Shore's CWC requirement. Accordingly, the Companies should incorporate these methodological adjustments into their revised CWC calculations.

As Staff recognized, capitalized expenditures generally are not included in CWC calculations. If they were, there would be an imbalance balance between revenues and expenses and rate base would be distorted because capitalized expenditures would effectively be included twice: once directly and once through the inclusion of CWC requirements. Accordingly, the Companies should exclude all capitalized expenditures, including the select payroll-related expenditures Staff proposed to include, from their revised CWC calculations.

Although real estate taxes have a longer lead time than most other Taxes Other Than Income Taxes, there are other such taxes, like FICA, that have shorter lead times than most other Taxes Other Than Income Taxes. Accordingly, the variable length of lead times is not a compelling reason to differentiate between individual taxes within the class of Taxes Other Than Income Taxes. Moreover, treating any of the individual taxes separately would improperly afford disproportionate weight to such taxes because all of the other taxes are dollar weighted. Therefore, in the Companies' revised CWC calculations, they should treat real estate taxes in the same manner they treat all other Taxes Other Than Income Taxes.

Finally, because pass through taxes effect the Companies' cash flow, the Companies should consider pass through taxes when calculating the expense lead time of Taxes Other Than Income Taxes. However, the dollar expense associated with pass through taxes should not be included in their calculations because the Companies do not bear ultimate responsibility for pass through taxes.

F. Gas in Storage

1. Working Capital

North Shore / Peoples Gas

To ensure that they will have gas sufficient to fill their customers' needs, the Utilities purchase gas and inject it into storage fields. For accounting purposes, the Utilities initially record all such stored gas as working inventory. Later, based on studies performed to determine the percentage of stored gas that should be considered "working" or "top" gas and the percentage that should be considered "cushion" or "base" gas, the Utilities reclassify appropriate quantities of top gas and record it as base gas. PGL/NS Ex.-TEZ 3.0, 37:811-23.

In accordance with the Uniform System of Accounts, stored gas classified as top gas is included in rate base as working capital and recorded as Gas in Storage; gas that is classified as base gas is included in rate base as part of net plant. *See, e.g.*, PGL Ex. SF-1.0, 11:224-36, NS Ex. SF-1.0, 11:228-28; 83 Ill. Admin. Code 505.1170, 505.1641.

Based on 13 month averages as of the end of the test year, fiscal year 2006, *i.e.*, as of September 30, 2006, Peoples Gas' working capital allowance in rate base for Gas in Storage is \$86,667,000, and North Shore's is \$10,507,000. *E.g.*, PGL Ex. SF-1.0, 15:322-16:334; PGL Ex. SF-1.1, Sched. B-1, line 6 and Sched. B-8.1, column [M]; NS Ex. SF-1.0, 15:319-332; NS Ex. SF-1.1, Sched. B-1, line 6 and Sched. B-8.1, column [M].

Staff

[Insert]

North Shore / Peoples Gas Response

The Utilities opposed Staff's recommendation that the Commission reduce their Gas in Storage because they had more gas in storage at the end of the test year than at the end of certain prior years. The Utilities explained that the difference was primarily due to weather, noting that the exceptionally warm winter in 2006 resulted in them pulling less gas out of storage to meet customer needs than they might otherwise have had to withdraw. NS-PGL Ex. TEZ-2.0, 74:1636-46. The Utilities also pointed out that Staff conceded that a utility does not necessarily cycle all of its working gas, depending on the winter weather. D. Anderson, Tr. at 473:11-18.

The Utilities further explained that Staff's proposed adjustment to working inventory should have no net impact on total rate base, and therefore should actually result in a disallowance. In accordance with applicable regulatory requirements, the Utilities are allowed to include the cost of all gas stored underground in their rate base, e.g., PGL Ex. SF-1.1, Sched. B-1, lines 1, 6; 83 Ill. Admin. Code §§ 505.1170, 505.1641, regardless of whether that gas is classified as top gas or base gas. Thus, the Commission's acceptance of Staff's proposed disallowance relative to the Utilities' working capital allowance for Gas in Storage would mean, at most, that the value of the Utilities' base gas would have to be adjusted upward by an equal amount.

Commission Analysis and Conclusion

The Utilities are permitted to include all of their costs of gas stored underground in rate base. Whether those costs are included in rate base as a working capital allowance for Gas in Storage or as part of net plant is solely dependent on whether the gas is classified as top gas or base gas, and all stored gas is one or the other by definition. Instead, Staff proposed a downward adjustment to the Utilities' Gas in Storage based on the difference between the quantity of underground gas on hand at the end of the test year versus other years. That the Utilities may not have accurately predicted the amount of top gas they would cycle out of their storage fields in the test year is not a legitimate basis on which to disallow a portion of the costs of that top gas, and if there were any downward adjustment, the value of the storage gas included in the Utilities' rate base as part of net plant would have to be increased by a commensurate amount. Absent a precise delineation of top gas versus base gas, which is unnecessary for this purpose, the Commission rejects Staff's proposed downward adjustment of the Utilities' Gas in Storage.

2. Accounts Payable

North Shore / Peoples Gas

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff's proposed adjustments to impose accounts payable offsets against the Gas in Storage in rate base are unjustified and should be rejected. The Gas in Storage in rate base is fully funded by investors and has been for over a year. The Utilities paid for the Gas in Storage in rate base, and there are no accounts payable for the Gas in Storage in rate base. Under the applicable standard contract, the Utilities paid for this storage gas within 16 days from the receipt of the invoices from the vendors. Fiorella Supp. Reb., NS-PGL Ex. 3.0, 2:22-42. Further, the Utilities' Gas in Storage in rate base is based on thirteen month averages as of the end of the test year, fiscal year 2006, i.e., as of September 30, 2006. *E.g.*, Fiorella, Dir. PGL Ex. SF-1.0, 15:322 – 16:334; PGL Ex. SF-1.1, Sched. B-1, line 6, and Sched. B-8.1, column [M]; NS Ex. SF-1.0, 15:319-332; NS Ex. SF-1.1, Sched. B-1, line 6, and Sched. B-8.1, column [M]. Hence, the accounts payable relating to the Gas in Storage in rate base were paid over a year ago, and in each instance they were paid no more than 16 days from when the Utilities received the invoices from the vendors.

Staff does not dispute that the Utilities paid in full for the Gas in Storage included in their rate bases over a year ago, and the evidence of that fact is uncontradicted. 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* Staff Ex. 3.0 Supp., 2:40-42.

Instead, Staff in rebuttal and in its Initial Brief points to 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., as of September 30, 2006, and argues that this means that a portion of the Gas in Storage balances was "financed by vendors" as of September 30, 2006. 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].

Further, 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. Although the thirteen-month average included the balance for the month ending on September 30, 2006, and there were accounts payable as of 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 (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]; 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 is 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. Staff Ex. 15.0, Sched. 15.3 P, p. 2., lines 4-7, Sched. 15.3 N, p. 2, lines 3-7. The facts that, some of the time, the Utilities owe amounts for Gas in Storage, and that they pay the invoices for that storage gas within no more than 16 days, do 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. Re.b, 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.

Commission Analysis and Conclusion

The Commission finds that Staff's proposed adjustments to impose accounts payable offsets against the Gas in Storage in rate base lack merit and should not be approved. Although vendors arguably "finance" the storage gas, the Utilities pay vendors' invoices in no more than 16 days. The Utilities must, and do, pay those invoices, and all of the invoices at issue here have been paid by the Utilities, based on the historical test year used in these proceedings. Staff's proposed adjustments, therefore, unreasonably seek to deny the Utilities' return on substantial amounts of their actual historical investments in the Gas in Storage in rate base and should be rejected.

G. OPEB Liabilities and Pension Asset/Liability

North Shore / Peoples Gas

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. LMK-2.0 2REV, 12:260 – 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.*, NS-PGL Ex. LMK-2.0 2REV, 12:260 – 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. LMK-2.0 2REV, 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. During the test year, fiscal year 2006, Peoples Gas and North Shore contributed \$15,278,614 and \$1,862,247, respectively, to the pension plan. Kallas Sur., NS-PGL Ex. LMK-3.0, 3:55-57.

Other Parties

[Insert]

North Shore / Peoples Gas Response

GCI and Staff 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. GCI and Staff’s proposed reductions of \$55,563,000 and \$7,094,000 from the rate bases of Peoples Gas and North Shore, respectively, are unfair and one-sided and should be rejected.

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 \$1,862,257 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; but, 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.

Accordingly, GCI’s and Staff’s position, that OPEB liabilities should be deducted when calculating the Utilities’ rate bases, should be rejected. The proposed reductions are incomplete and one-sided in that they exclude Peoples Gas’ net pension asset of \$110 million, to which Peoples Gas contributed over \$15 million in the test year, along with North Shore’s net pension liability of \$24,000. 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.

Commission Analysis and Conclusion

The Commission rejects GCI’s and Staff’s position, that OPEB liabilities should be deducted when calculating the Utilities’ rate bases, because it unfairly excludes Peoples Gas’ net pension asset and North Shore’s net pension liability. Staff’s citations to prior Commission orders addressing ratepayer-funded pension contributions are inapposite.

Alternative A

The Commission finds that the Utilities' OPEB liabilities will be deducted, but, for the reasons provided by the Utilities, Peoples Gas' net pension asset of \$110,000,000 and North Shore's net pension liability of \$24,000 will be incorporated into the calculation of the rate bases.

Alternative B

The Commission finds that Peoples Gas and North Shore contributed \$15,278,614 and \$1,862,247, respectively, to the pension plans during the test year. The Commission finds that the Utilities' OPEB liabilities will be deducted, but, for the reasons provided by the Utilities, Peoples Gas' contributions of \$15,278,614 and North Shore's contributions of \$1,862,247 to the pension plan also should be incorporated into the calculation of the rate bases.

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

Other than GCI's two uncontested proposed adjustments discussed in Section II(B)(5) and (6) of this Order, Staff and intervenors have not proposed any independent adjustments to ADIT as such. Accordingly, the Commission's final Order, as to ADIT, need only make derivative calculations reflecting the approved adjustments that have derivative impacts on ADIT.

III. OPERATING EXPENSES

A. Overview

Peoples Gas' and North Shore's final proposed operating expenses figures are shown on their Revised Schedule C-1's. NS-PGL Ex. SF-4.3P and SF-4.3N. The Utilities have agreed to or accepted, in order to narrow the issues, a total 18 different adjustments to operating expenses proposed by Staff and GCI, as is reflected in Section III(B) of this Order. The Utilities' final proposed operating expenses figures appropriately and correctly reflect the prudent and reasonable expenses that they have incurred in order to serve their customers and that should be approved for recovery through rates.

Staff proposes five contested adjustments to operating expenses, and GCI proposes one contested adjustment to operating expenses that essentially is the same as one that Staff proposes. None of Staff's and GCI's contested proposed operating expenses adjustments are warranted. All of those adjustments would incorrectly deny the Utilities recovery of expenses that they have incurred in order to serve and benefit their customers. They are rejected. The contested adjustments are discussed in Section III(C) of this Order.

B. Uncontested Issues

1. Storage Expenses (Compressor Station Fuel Expenses) (PGL)

Other Parties

[Insert]

Peoples Gas Response

Peoples Gas witness Ms. Kallas accepted a GCI proposal to adjust Peoples Gas' expenses relating to compressor station operating fuel as long as it was recalculated based on updated fuel prices and fiscal year 2006 volumes, which resulted in a \$953,000 adjustment (gross amount). PG-NGL Ex. LK-2.0, 14:294-309; PGL Ex. LK-2.3. GCI witness Mr. Effron agreed with that recalculated amount. GCI Ex. 5.0, 12:283-294.

Commission Analysis and Conclusion

The Commission finds that the proposed adjustment to Peoples Gas' expenses relating to compressor station operating fuel as revised, resulting in a \$953,000 adjustment (gross amount) to Peoples Gas operating expenses, is uncontested, reasonable and appropriate, and therefore approves it.

2. Distribution Expenses

a. Non-Payroll Expenses Inflation

North Shore / Peoples Gas

The Utilities proposed *pro forma* adjustments for expected 2007 inflation in non-payroll expenses of \$3,084,000 as to Peoples Gas and \$542,000 as to North Shore (gross amounts). PGL Ex. SF-2.0, 27:598-602; NS Ex. SF-2.0, 26:567-71.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities stated that they were willing to withdraw the proposed *pro forma* non-payroll expenses inflation adjustments as a result of Staff and GCI contentions that the Utilities' proposal was inconsistent with that rule's provision regarding adjustments based on attrition and inflation factors and that the adjustments were insufficiently particularized to be known and measurable. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:103 and fn. 2, 12:264 – 13:279, 13:281-290; NS-PGL Exs. SF-2.3P, 2.7P, and 2.8P.

Commission Analysis and Conclusion

The Commission finds that the withdrawal of the Utilities' *pro forma* non-payroll expenses inflation adjustments is uncontested and, therefore, approves the withdrawal.

b. Customer Installation Expenses (NS)

North Shore

Other Parties

[Insert]

North Shore Response

North Shore does not contest the removal of \$175,000 of customer installation expenses (gross amount) proposed by Staff witness Ms. Pearce. NS-PGL Ex. SF-2.0, 4:82-90, 5:104.

Commission Analysis and Conclusion

The Commission finds that the removal of \$175,000 of customer installation expenses (gross amount) from North Shore's operating expenses is uncontested and reasonable, and, therefore, approves it.

c. City of Chicago Resurfacing Expenses (PGL)

Peoples Gas

Peoples Gas, in direct testimony, proposed the *pro forma* adjustment for City of Chicago resurfacing expenses (which has rate base and operating expenses components) in the gross amounts amount of \$1,400,000 (rate base) and \$2,100,000 (expense). PGL Ex. SF-1.0, 19:403-410, 30:659-667; PGL Ex. SF-1.1, Scheds. B-2.2, C-2.28

Other Parties

[Insert]

Peoples Gas Response

Peoples Gas updated its *pro forma* adjustments for City of Chicago resurfacing expenses in rebuttal testimony, providing for additional gross amounts of \$4,397,000 (rate base) and \$6,596,000 (expense). NS-PGL Ex. SF-2.0, 12:264 – 13:279; NS-PGL Exs. SF-2.3P and 2.7P. Peoples Gas in its surrebuttal testimony did not contest further adjustments by GCI that reduce Peoples Gas' rebuttal testimony updated figures by the gross amounts as to rate base of \$1,080,000 and as to operating expenses of \$1,620,000. NS-PGL Ex. 4.0, 6:132-135.

Commission Analysis and Conclusion

The Commission finds that the *pro forma* adjustments for City of Chicago resurfacing expenses as updated in Peoples Gas' rebuttal testimony, subject to the revisions proposed by GCI and accepted by Peoples Gas in surrebuttal testimony, which reduce rate base (gross plant) by the gross amounts of \$1,080,000 and operating expenses by \$1,620,000 from the updated levels in Peoples Gas' rebuttal testimony, are not contested, reasonable, and appropriate, and therefore approves them.

3. Customer Accounts Expenses (Uncollectible Accounts Expenses)

Other Parties

[Insert]

North Shore / Peoples Gas Response

After GCI witness Mr. Effron recalculated proposed adjustments to Peoples Gas' and North Shore's operating expenses relating to uncollectible accounts expenses and Staff withdrew its proposed adjustment, North Shore and Peoples Gas witness Ms. Kallas responded that the Companies were willing to accept the GCI proposals, but only if they were recalculated based on updated fuel prices and fiscal year 2006 volumes, which results in adjustments of \$3,283,000 as to Peoples Gas and \$103,000 as to North Shore (gross amounts). Kallas Reb., NS-PGL Ex. LK-2.0 REV, 14:294 – 15:313; NS-PGL Ex. LK-2.3. Mr. Effron agreed with the recalculated amounts. GCI Ex. 5.0, 9:225 – 10:240.

Commission Analysis and Conclusion

The Commission finds that adjustments to Peoples Gas' and North Shore's operating expenses to reduce uncollectible accounts expenses by \$3,283,000 for Peoples Gas and by \$103,000 for North Shore (gross amounts), are uncontested and reasonable and, therefore, approves them.

4. Customer Service and Information Expenses

a. "Advertising" Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

North Shore and Peoples Gas do not contest Staff witness Mr. Kahle's proposed adjustments to remove what he contended were promotional, goodwill, or institutional advertising expenses from operating expenses in the gross amounts of \$308,000 as to Peoples Gas and \$43,000 as to North Shore. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:100.

Commission Analysis and Conclusion

The Commission finds that the adjustments to Peoples Gas' and North Shore's operating expenses to reduce "advertising" expenses by \$308,000 for Peoples Gas and by \$43,000 for North Shore (gross amounts), are uncontested and, therefore, approves them.

b. Dues and Memberships Expenses (PGL)

Peoples Gas

Other Parties

[Insert]

Peoples Gas Response

Peoples Gas does not contest Staff witness Mr. Kahle's proposed adjustment to remove certain membership dues in the gross amount of \$14,000 from Peoples Gas' operating expenses. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:101.

Commission Analysis and Conclusion

The Commission finds that the reduction in the gross amount of \$14,000 in Peoples Gas' operating expenses relating to certain membership dues is not contested and is reasonable and, therefore, approves it.

5. Administrative & General Expenses

a. Civic, Political, and Related Activities Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

North Shore and Peoples Gas do not contest Staff witness Ms. Hathhorn's proposal to adjust Peoples Gas' operating expense by \$80,000 and North Shore's operating expense by \$11,000 (gross amounts) due to the expenses being classified as civic, political and related activities. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:92.

Commission Analysis and Conclusion

The Commission finds that the proposals to reduce Peoples Gas' operating expenses by \$80,000 and North Shore's operating expenses by \$11,000 (gross amounts) due to the expenses being classified as civic, political, and related activities are not contested and are reasonable and, therefore, approves them.

b. Employee Recreation Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Ms. Hathhorn's proposed adjustments to remove expenses for employee recreation in the gross amounts of \$54,000 as to Peoples Gas and \$7,000 as to North Shore from operating expenses. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:93.

Commission Analysis and Conclusion

The Commission finds that the uncontested proposals to reduce Peoples Gas' operating expenses by \$54,000 and North Shore's operating expenses by \$7,000 (gross amounts) for activities relating to employee recreation are reasonable and, therefore, approves them.

c. Corporate Rebill of Income Tax Penalties

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Ms. Hathhorn's proposed adjustments to remove the rebilling of income tax penalties from Peoples Energy Corporation to the Utilities in the gross amounts of \$35,000 as to Peoples Gas and \$5,000 as to North Shore. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:97.

Commission Analysis and Conclusion

The Commission finds that Staff witness Ms. Hathhorn's proposed adjustments to remove the rebilling of income tax penalties from Peoples Energy Corporation to the Utilities in the gross amounts of \$35,000 as to Peoples Gas and \$5,000 as to North Shore are uncontested and reasonable and, therefore, approves them.

d. Lobbying Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Mr. Kahle's proposed adjustments to disallow lobbying expenses from rate base and operating expenses in the gross amounts of \$12,000 (capitalized) and \$67,000 (operating expenses) as to Peoples Gas and \$3,000 (capitalized) and \$13,000 (operating expenses) as to North Shore. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:99.

Commission Analysis and Conclusion

The Commission finds that the proposed adjustments to remove lobbying expenses from rate base and operating expenses in the gross amounts of \$12,000 (capitalized) and \$67,000 (operating expenses) as to Peoples Gas and \$3,000 (capitalized) and \$13,000 (operating expenses) as to North Shore are not contested and are reasonable and, therefore, approves them.

e. Executive Perquisites Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Ms. Pearce's proposed adjustments to remove executive perquisites in the gross amounts of \$170,000 as to Peoples Gas and \$15,000 as to North Shore from operating expenses. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:105.

Commission Analysis and Conclusion

The Commission finds that Staff's proposed adjustments to remove executive perquisites from operating expenses in the gross amounts of \$170,000 as to Peoples Gas and \$15,000 as to North Shore are uncontested and reasonable and, therefore, approves them.

f. Termination Costs (PGL)

Other Parties

[Insert]

Peoples Gas Response

Peoples Gas does not contest Staff witness Ms. Pearce's proposed adjustment to remove a gross amount of \$259,000 in termination costs from Peoples Gas' operating expenses. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:106.

Commission Analysis and Conclusion

The Commission finds that the proposed adjustment to remove a gross amount of \$259,000 in termination costs from Peoples Gas' operating expenses is not contested and is reasonable and, therefore, approves it.

g. Salaries and Wages Expenses

North Shore / Peoples Gas

North Shore and Peoples Gas proposed *pro forma* adjustments for salary and wage increases in the gross amounts of \$3,576,000 for Peoples Gas and \$431,000 for North Shore. Fiorella Dir., PGL Ex. SF-1.0, 26:575-586; PGL Ex. SF-1.1, Schedules. C-2.13, C-2.14; Fiorella Dir., NS-Ex. SF-1.0, 25:544-555; NS Ex. SF-1.1, Schedules. C-2.13, C-2.14.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Ms. Pearce's proposed adjustments, reflecting the Utilities' corrections to errors in their underlying calculations supporting their *pro forma* adjustments for salaries and wage increases, increasing operating expenses by the gross amounts of \$124,000 as to Peoples Gas and \$25,000 as to North Shore. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:107.

Commission Analysis and Conclusion

The Commission finds that Staff's proposed adjustments to the Utilities' salaries and wage increases, which increases *pro forma* operating expenses by the gross amounts of \$124,000 as to Peoples Gas and \$25,000 as to North Shore, are uncontested and reasonable and, therefore, approves them.

h. Medical and Insurance Expenses

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest GCI witness Mr. Effron's proposed adjustments to operating expenses, reducing Peoples Gas' medical and insurance expenses by the gross amount of \$866,000, and reducing North Shore's medical and insurance expenses by the gross amount of \$83,000. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:112.

Commission Analysis and Conclusion

The Commission finds that the proposed adjustments to operating expenses, reducing Peoples Gas' medical and insurance expenses by the gross amount of \$866,000, and reducing North Shore's medical and insurance expenses by the gross amount of \$83,000, are uncontested and reasonable and, therefore, approves them.

i. Rate Case Expenses

North Shore / Peoples Gas

The Utilities proposed rate cases expenses to be included in operating expenses, with the rate case expenses to be amortized over three years and with no adjustment to be made for carrying charge expenses. Fiorella Dir., PGL Ex. 1.0, 23:497-505; Fiorella Dir., NS Ex. 1.0, 22:470-78.

Other Parties

[Insert]

North Shore / Peoples Gas Response

Initially, in response to Staff and GCI's proposals in direct testimony that all rate case expenses be amortized over five years, Peoples Gas and North Shore proposed in rebuttal testimony that if the five-year amortization period were to remain intact, they should be able to include the amortized amount in rate base. Fiorella Reb., NS-PGL SF-2.0, 6:115-27. Also, in response to Staff's proposed adjustments to the amounts, Peoples Gas and North Shore provided updated data (actual amounts incurred and updated estimates for the remaining amounts) in their rebuttal testimony. *Id.*, 6:128 – 8:164; NS-PGL Exs. SF-2.9P and SF-2.9N

Staff in rebuttal testimony generally accepted the updated data, but Staff did propose adjustments to certain amounts. On surrebuttal, the Utilities withdrew their request to include the amortized amount in rate base and accepted Staff's revised adjustments, i.e., Staff's rebuttal adjustments to the updated amounts. Fiorella Sur., NS-PGL Ex. SF-4.0, 5:97-107; NS-PGL Exs. SF-4.4P, column [C], and SF-4.4N, column [C].

Thus, the Utilities do not contest the final revised proposed adjustments of Staff to operating expenses that reduce Peoples Gas' and North Shore's rate case expenses, as updated in rebuttal testimony, by the gross amounts of \$680,000 and \$690,000, respectively, with all rate case expenses to be amortized over five years, and excluding the amortized amount from rate base.

Commission Analysis and Conclusion

The Commission finds that the proposed adjustments in Staff's rebuttal testimony to the amounts of the updated rate case expenses of the Utilities, and Staff's and GCI's proposals to amortize rate case expenses over a five-year period without carrying charges, are uncontested and reasonable and, therefore, the Commission approves them.

j. Franchise Requirements Expenses (NS)

Other Parties

[Insert]

North Shore Response

In response to GCI witness Mr. Effron's direct testimony in which he recalculated the proposed adjustment to North Shore's operating expenses relating to franchise requirements expenses, North Shore and Peoples Gas witness Ms. Kallas stated that North Shore was willing to accept the proposal, but only if it were recalculated based on updated fuel prices and fiscal year 2006 volumes, which results in a \$584,000 adjustment (gross amount). Kallas Reb., NS-PGL Ex. LK-2.0 REV, 14:294-309; NS-PGL Ex. LK-2.3. Mr. Effron agreed with that recalculated amount. Effron Reb., GCI Ex. 5.0, 11:269 – 12:280. No other witness disagreed.

Commission Analysis and Conclusion

The Commission finds that the proposed reduction in North Shore's operating expenses in the amount of \$584,000 (gross amount) is not contested and is reasonable and, therefore, approves it.

k. PEC Officer Costs and Directors Fees

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff witness Ms. Hathhorn's revised proposed adjustments to operating expenses that removes Peoples Energy Corporation officer costs and directors' fees that were allocated to Peoples Gas in the gross amount of \$702,000 and to North Shore in the amount of \$100,000. Fiorella Sur., NS-PGL Ex. SF-4.0, 6:126-130.

Commission Analysis and Conclusion

The Commission finds that Staff's revised proposed adjustments to remove officer costs and directors' fees that were allocated to Peoples Gas in the gross amount of \$702,000 and to North Shore in the gross amount of \$100,000 are uncontested and, therefore, approves them.

6. Taxes Other Than Income Taxes (Personal Property Taxes)

Peoples Gas

On rebuttal, Peoples Gas revised its Taxes Other Than Income Taxes to include a proposed personal property taxes gross amount increase of \$1,181,000, reflecting a court

decision. Fiorella Reb., NS-PGL 2.0, 13:281-290; NS-PGL Ex. SF-2.8 P. No party contested this adjustment.

Commission Analysis and Conclusion

The Commission finds that the inclusion for Peoples Gas of an additional gross amount of \$1,181,000 in personal property taxes in Taxes Other Than Income Taxes pursuant to a recent court decision is not contested by any party, is reasonable and appropriate, and therefore approves it.

7. Income Taxes (Interest Synchronization)

North Shore / Peoples Gas

Peoples Gas proposed that its Interest Synchronization component of income taxes be calculated as \$1,894,000, thus reducing income taxes by that amount. Fiorella Dir., PGL Ex. SF-1.0, 25:548-51; PGL SF-Ex. 1.1, Sched. C-2.8. North Shore proposed that its Interest Synchronization component of income taxes be calculated as \$451,000, thus reducing income taxes by that amount. Fiorella Dir., NS Ex. SF-1.0, 24:520-23; NS Ex. SF-1.1, Sched. C-2.8.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not contest Staff's proposal that the Interest Synchronization component of income taxes should be recalculated, for purposes of final approved revenue requirement calculations, based on the final approved rate base times the weighted cost of debt. Fiorella Reb., NS-PGL Ex. SF-2.0, 4:82-90, 5:94-95.

Commission Analysis and Conclusion

The Commission finds that Staff's proposal that, for purposes of final approved revenue requirement calculations, the Interest Synchronization component of income taxes should be recalculated based on the final approved rate base times the weighted cost of debt, is not contested and is reasonable and, therefore, it is approved.

C. Contested Issues

1. Storage Expenses

a. Crankshaft Repair Expenses (PGL)

Peoples Gas

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.

Other Parties

[Insert]

Peoples Gas Response

GCI proposed that, because of the unusual nature of the crankshaft failure, 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, i.e., to \$136,000, in calculating the revenue requirement. GCI Ex. 2.0, 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. SF-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].

In contrast, Staff 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. This proposal denies all cost recovery, ignoring the fact that the Utilities actually incurred expenses that were unusual for the test year.

GCI's proposal is the more reasonable of the two proposals, because it accounts for the fact that Peoples Gas actually incurred these expenses in the test year and the fact that the expenses were unusual.

No party denies that the expenses were prudent, reasonable, and needed. Staff makes the point that the crankshaft failure was a very unlikely event (Staff Init. Br. at 27), 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 the Companies. GCI Ex. 2.0, 32:722 – 33:738 and Sched. C-2 (Peoples Gas); Fiorella Reb., NS-PGL Ex. SF-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]. The Utilities should be allowed to recover this amount.

Commission Analysis and Conclusion

The Commission accepts GCI's proposal as fair and reasonable and finds that the Utilities should be allowed to recover \$136,000 as the amortization amount for crankshaft repair expenses. Staff's proposal is rejected. No party denies that the expenses were prudent, reasonable, and needed. Staff makes the point that the crankshaft failure was a very unlikely event, but, under the specific facts of this case, that does not support denying recovery of these prudent, reasonable, and needed expenses.

b. Hub Services (PGL) (Addressed in Section V, below)

2. Customer Accounts Expenses (Collection Agency Fees)

North Shore/Peoples Gas

In calculating their revenue requirements, the Utilities appropriately substituted three year averages of the collection agency fees incurred in fiscal years 2003 through 2005 for the level in the test year, fiscal year 2006, because the latter was abnormally low due to the 2006 Gas Charge settlement. Fiorella Dir., PGL Ex. SF-1.0, 28:603-607; PGL Ex. SF-1.1, Sched. C-2.19; Fiorella Dir., NS Ex. SF-1.0, 26:572-576; NS Ex. SF-1.1, Sched. C-2.19. The dramatic effect of the settlement on the test year level of the fees is illustrated in the charts on page 43 of the Utilities' Initial Brief.

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff proposes that the Utilities be required to use the test year level in calculating their revenue requirements, resulting in proposed disallowances in the gross amounts of \$1,770,000 and \$76,000 as to Peoples Gas and North Shore, respectively. Staff Ex. 1.0, 8:162 – 12:252, Sched. 1.8P, p. 1, Sched. 1.8N, p. 1. Staff's proposal is unsound.

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 support, 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 (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. As North Shore and Peoples Gas witness Ms. Kallas stated:

Collection agencies are used to collect on older bad debt accounts. Therefore, fiscal years 2006 and 2007 amounts are artificially low due to the companies' agreement to not attempt to collect accounts that had been written-off and remained uncollected as of September 30, 2005. Accounts written off subsequent to September 30, 2005, however are not forgiven and have been and will be assigned to collection agencies for collection. This will result in collection agency fees being substantially more than experienced in the test year. A good estimate of the expected level of collection agency fees for the first year that the rates set in this proceeding will be in effect is the fiscal year 2003 through 2005 average used in Mr. Fiorella's proposed adjustment. In other words, the averaging of actual experience not affected by the agreement (i.e., fiscal years 2003 through 2005) is much more indicative of normal activity and cost for this account.

Kallas Reb., NS-PGL Ex. LK-2.0 REV, 5:93-104.

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 Order, *infra*.

Further, 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 to 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 2REV, 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.

Commission Analysis and Conclusion

The Commission approves the Utilities' adjusted collection agency fees levels and rejects Staff's proposed disallowances of \$1,770,000 for Peoples Gas and \$76,000 for North Shore. The Utilities' adjustments are appropriate in light of the abnormally low test year levels, using a methodology that yields figures more likely to be representative of the expenses in the years in which the rates set in these proceedings will be in effect. Staff's proposal overlooks the fact that the Utilities' 2006 and 2007 collection agency fees were understated due to the Gas Charge

settlement agreement. Finally, the Utilities' proposal is consistent with the terms of the Gas Charge settlement.

3. Administrative & General Expenses

a. Injuries and Damages Expenses

North Shore / Peoples Gas

The Utilities incorporated their respective appropriate levels of injuries and damages expenses in calculating their revenue requirements. Peoples Gas appropriately used the 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, line 30, and Sched. C-2.30. 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.

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff's proposed adjustments to injuries and damages expenses are unwarranted and arbitrary, and should be rejected. Staff's witness proposes 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 Staff Ex. 16.0, Schedules 16.2 P and 16.2 N. Staff's witness, in his direct testimony, contended that the levels of injuries and damages expenses fluctuate and therefore should be normalized; proposed the above methodology to set the levels; and cited *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*"). Staff Ex. 4.0, 8:136 – 9:159. He offered no reason for selecting a five year normalization methodology, as opposed to some other period, apart from that citation.

North Shore and Peoples Gas witness Ms. Kallas, in her rebuttal testimony, noted data errors made by Staff's witness, and pointed out that normalization was unwarranted here. NS-PGL Ex. LK-2.0 REV, 9:198 – 11:226. Staff's witness, in his rebuttal testimony, corrected his data errors, but expressed the view that the differences between his corrected averages and

the Utilities' proposed levels, 14% as to Peoples Gas and 22% as to North Shore, were significant enough that his proposed adjustments should be made. Staff Ex. 16.0, 7:128-139. He still did not provide any specific support for his choice of the five year period that yielded those percentages.

Ms. Kallas, in her surrebuttal testimony again disagreed that normalization is warranted, pointed out that Staff's witness still had not provided any specific support for his choice of a five year period, and further pointed out that using four and three year periods would not support Staff's proposed adjustments, and, in fact, a four year average would increase the levels of injuries and damages expenses included in the revenue requirements of both of the Utilities:

Considering the relative closeness of this expense in the test year to the five year period chosen by Mr. Griffin, there is no good reason this expense should be normalized. Moreover, Mr. Griffin does not explain why he chose to use five years. If four years were used for Peoples Gas (fiscal years 2003 through 2006), it would indicate a higher "normalized" expense than actual fiscal year 2006. If a three year period is chosen for Peoples Gas, the "normalized" expense would almost equal the fiscal year 2006 accrual. The results are even more significant for North Shore where excluding fiscal 2002 in the calculation results in cash payments much higher than accruals.

NS-PGL Ex. LMK-3.0, 5:93-100.

In *CILCO 2006*, the case cited by Staff's witness, Staff looked at five years of data, but then discarded, in each instance, data from one year that Staff considered unrepresentative, resulting in Staff's use of four-year averages. Here, the fiscal year 2002 data that Staff uses is very different from the data for the other four years (*see* Staff Ex. 16.0, Scheds. 16.2 P and 16.2 N), and, as indicated above, excluding that one year would result in increases, not decreases, in the levels of injuries and damages expenses included in the revenue requirements of both of the Utilities. The Commission should reject Staff's proposed adjustments because there is no significant reason to normalize these expenses, and it is evident that Staff's choice of a five year period is arbitrary and unwarranted.

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, Staff's claim is incorrect.

Staff's exhibits (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

The levels shown above 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. Although Staff claims it has not been shown that fiscal year 2002 is an “outlier” (Staff Init. Br. at 33), the data above refute that claim. Thus, there is no valid factual basis for the proposed disallowances.

Further, 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* 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 could not be clearer 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.

Finally, 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 Order.

Commission Analysis and Conclusion

The Commission rejects Staff’s proposed adjustments and finds that 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. 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.

b. Incentive Compensation Expenses

(i) Recovery of All of the Challenged Incentive Compensation Costs

Other Parties

[Insert]

North Shore / Peoples Gas Response

Peoples Gas and North Shore seek to recover \$5,376,000 and \$576,000, respectively, of incentive compensation program costs (gross amounts, including capitalized expense amounts and operating expenses (including associated payroll taxes in Taxes Other Than Income Taxes)) in their revenue requirements. Staff Ex. 2.0, Scheds. 2.2P and 2.2N. These costs are prudent and reasonable in amount, and the Utilities should be allowed to recover them. Staff and GCI propose to disallow all of these costs, but their proposals are erroneous and unreasonable, and should be rejected. In the alternative, at a minimum Peoples Gas and North Shore should be allowed to recover (1) \$1,009,240 and \$94,204, respectively, under the Team Incentive Award (“TIA”) plan; and (2) \$625,791 and \$53,107, respectively, under the Individual Performance Bonus (“IPB”) plan.

Like other large companies, Peoples Gas and North Shore include incentive compensation as part of their overall employee compensation packages. The Utilities must offer incentive compensation in order to provide the competitive compensation package necessary to attract and to retain high-quality employees: “The Utilities and other large businesses seek to design employee compensation in order to attract and retain a sufficient, qualified, and motivated work force. Incentive compensation programs are a common method to help achieve those objectives.” Hoover Reb., NS-PGL Ex. JCH-1.0, 3:55-57. No witness challenged this testimony.

Incentive compensation programs were a contributing factor in Peoples Gas and North Shore’s reduction of O&M expenses below target levels. Hoover / Volante Sur., NS-PGL Ex. JCH/FLV-2.0, 6:112-117. The Commission has recognized that incentive compensation programs that reward employees for lowering operating costs benefit customers. *See In re Commonwealth Edison Co.*, ICC Docket No. 01-0423, at 129 (Order, March 28, 2003); *In re Consumers Illinois Water Co.*, ICC Docket No. 03-0403, at 14-15 (Order, April 13, 2004); *In re Northern Illinois Gas Co.*, ICC Docket No. 95-0219, at 27 (Order, April 3, 1996). While Staff suggests that controlling and reducing costs do not count as benefiting customers, that is illogical and is inconsistent with the Commission orders upon which Staff relies. NS-PGL Ex. JCH/FLV-2.0, 4:72 – 5:92. In fact, Staff admits that measures tied to customer satisfaction directly benefit ratepayers. Staff Ex. 2.0, 19:430-432.

Incentive compensation plainly qualifies as a prudent expense. “The Utilities compete in the labor market with other utilities and other businesses that offer incentive compensation.... [T]he programs are the product of careful decisions about what types and levels of incentive compensation are needed in order to attract and retain a sufficient, qualified, and motivated work force....” NS-PGL Ex. JCH-1.0, 3:57-59, 8:150-153. Furthermore, incentive compensation for

that reason benefits a utility's customers: "A utility's attracting and retaining a sufficient, qualified, and motivated work force benefits its customers by making sure there are enough employees to perform needed work, by maintaining and improving the productivity and quality of work, and by reducing the expenses associated with recruiting and training new employees." *Id.* at 3:63-4:66. Again, no witness challenged this testimony.

No witness challenged Peoples Gas' and North Shore's total compensation to employees, or, in particular, the incentive compensation portions, as imprudent or excessive. No witness testified that their incentive compensation programs and payouts thereunder are not prudent and reasonable from the perspective of managing their human resources. NS-PGL Ex. JCH 1.0, 4:67-70. Indeed, it is clear that under the Staff and GCI positions, the amounts of incentive compensation that they challenge would not be challenged if the Utilities had paid the exact same amounts of total compensation but had made the incentive compensation amounts part of base pay. *See, e.g., Tr.*, 1196:3 – 1200:15. In light of this testimony, the Utilities' challenged incentive compensation costs merit full recovery through rates.

Staff and GCI incorrectly assert that the Utilities' incentive compensation programs only benefit shareholders and not ratepayers. Incentive compensation benefits customers through: increased customer satisfaction; improved service reliability; more efficient, lower cost operations that lead to lower rates over time when compared to less efficient operations; improved employee performance; enhanced ability to attract and to retain high-quality employees; and better employee productivity. These numerous benefits satisfy any Commission requirement that incentive compensation not only be prudent and reasonable but benefit customers. By claiming that more is required in the way of specific dollar savings, Staff and GCI advance an unsupportable and inconsistent interpretation of the Commission's past tests. In any event, their proposals would wrongly deny Peoples Gas and North Shore their right to recover all prudent and reasonable expenses. *See Citizens 1995*, 166 Ill. 2d at 121.

Additionally, there is no evidence in the record to suggest that Utilities will not incur incentive compensation expenses going forward. Although there were no payouts during fiscal year 2006 under the STIC plan, that was for unusual reasons that are not expected to reoccur. NS-PGL Ex. JCH-1.0, 6:108-110. Thus, Staff's and GCI's concerns on this point are illusory and unsupported by the record.

Further, Staff and GCI propose to deny Peoples Gas and North Shore recovery of the incentive compensation portions of their total compensation expense without disputing that the Utilities' total compensation and the incentive compensation portions are prudent or reasonable in amount. Staff Ex. 2.0, 6:134-18:451; GCI Ex. 2.0, 25:545 - 26-568. During cross-examination, GCI Witness Efron acknowledged that his testimony did not even address whether the Utilities' incentive compensation programs are prudent. *Tr.* at 1196:15-21. He further indicated that under his approach (which is the same as Staff's), it would not matter whether the Utilities' incentive compensation program helped to attract and retain the most qualified employees. *Tr.* at 1203:7-21. Staff witness Pearce made a similar admission:

[One of the reasons] given by Mr. Hoover in support of incentive compensation expense recovery in the 2006 test year is his belief that such plans "are prudently and reasonably designed in order to attract and retain a sufficient,

qualified and motivated work force.” This assertion made by Mr. Hoover, even if correct, does not detract from the basis of my adjustment.

Staff Ex. 14.0, 6:125-129. The proposed disallowances thus contravene the established principle that rates “must allow the utility to recover costs prudently and reasonably incurred.” *Citizens Utility Board v. Illinois Commerce Comm’n*, 166 Ill. 2d 111, 121 (1995).

Finally, although Staff and GCI cite to prior Commission Orders in which recovery for incentive compensation was disallowed, the Commission has approved recovery of incentive compensation expenses in various other rate cases, including: *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, at 97 (Order July 26, 2006); *In re Consumers Illinois Water Co.*, ICC Docket No. 03-0403, at 14-15 (Order April 13, 2004); *In re Illinois-American Water Co.*, ICC Docket No. 02-0690, at 17-19 (Order August 12, 2003); and *In re Commonwealth Edison Co.*, ICC Docket No. 01-0423, at 109-111 (Interim Order April 1, 2002), and at 120-122 (Order March 28, 2003). The Commission should do so here.

Peoples Gas and North Shore seek to recover costs associated with several specific programs within their incentive compensation plans. Those programs include: (1) the Team Incentive Award plan; (2) the Individual Performance Bonus plan; (3) the Short-term Incentive Compensation (“STIC”) plan; (4) officers’ incentive compensation and bonuses charged by Peoples Energy Corporation to Peoples Gas and North Shore; and (5) long-term incentives, such as restricted stock and performance shares, covered by the 2004 incentive compensation plan. The evidence regarding those plans shows that the proposed disallowances should be rejected.

Commission Analysis and Conclusion

The Commission finds that Peoples Gas and North Shore have demonstrated a steadfast commitment to incentive compensation that ensures they will continue to provide incentive compensation going forward. Thus, recovery at target level is proper.

The record also shows that Peoples Gas’ and North Shore’s incentive compensation expenses are in the interests of their customers. The undisputed record demonstrates that, without incentive compensation, the Utilities could not continue to attract the talent necessary to provide safe, efficient and reliable service to customers. The record also demonstrates that incentive compensation benefits customers through: increased customer satisfaction; improved service reliability; more efficient, lower cost operations that lead to lower rates than would result from less efficient operations; improved employee performance; enhanced ability to attract and to retain high-quality employees; and better employee productivity. Thus, Peoples Gas’ and North Shore’s incentive compensation expense is in fact reasonable and prudent and is approved.

Alternative A

The Commission finds that Peoples Gas and North Shore have demonstrated a steadfast commitment to incentive compensation that ensures they will continue to provide incentive compensation going forward. The record also shows that Peoples Gas’ and North Shore’s operational and non-financial incentive compensation expenses are in the interests of their customers. The Commission finds that Peoples Gas and North Shore should be allowed to

recover (1) \$1,009,240 for Peoples Gas and \$94,024 for North Shore for costs associated with the operational measures of the “TIA” plan (discussed below); (2) \$625,791 for Peoples Gas and \$53,107 for North Shore under the “IPB” plan (discussed below), which is tied to individual performance and is not tied to financial measures; (3) \$306,953 for Peoples Gas that was accrued as to the operational measures under the “STIC” plan (discussed below); (4) \$279,305 as to Peoples Gas (37.5% times \$744,812) plus \$62,179 (27.5% times \$165,811) as to North Shore that was accrued as to the operational measures for affiliate charges (discussed below); and (5) \$1,529,000 as to Peoples Gas for the restricted stock program (discussed below), which is tied to providing competitive compensation packages. These costs are reasonable and prudent, they benefit the Utilities’ customers, and they are tied to operational measures or, in the case of the “IPB” plan, individual performance and non-financial measures, and, in the case of the restricted stock program, non-financial measures.

Alternative B

The Commission finds that Peoples Gas and North Shore have demonstrated a steadfast commitment to incentive compensation that ensures they will continue to provide incentive compensation going forward. The record also shows that Peoples Gas’ and North Shore’s operational incentive compensation expenses are in the interests of their customers. The Commission finds that Peoples Gas and North Shore should be allowed to recover (1) \$1,009,240 for Peoples Gas and \$94,024 for North Shore for costs associated with the operational measures of the “TIA” plan (discussed below) and (2) \$625,791 for Peoples Gas and \$53,107 for North Shore under the “IPB” plan (discussed below), which is tied to individual performance and is not tied to financial measures. These costs are reasonable and prudent, they benefit the Utilities’ customers, and they are not tied to financial measures.

(ii) The TIA Plan

Other Parties

[Insert]

North Shore / Peoples Gas Response

The 2006 Team Incentive Award plan applied to non-officer, non-union employees. NS-PGL Ex. JCH-1.0, 4:74-75. The performance measures under the TIA plan were 55% “financial” and 45% “operational”. *Id.* at 4:76 – 5:80. The “operational” performance measures consisted of a 25% weighting for controlling O&M expenses and a 20% weighting for customer satisfaction criteria (10% based on the number of calls to the Utilities’ call centers and 10% based on the ranking of the Utilities’ Gas Charges compared with those of six other Illinois utilities.) *Id.* at 4:80 – 5:86. The Utilities demonstrated, in detail, that Staff’s attempts to deny that 45% of the measures were operational are not correct, and Staff actually admitted that the Call Center metric benefits customers. NS-PGL Ex. JCH/FLV-2.0, 5:105 – 7:146. Accordingly, while complete recovery of the entire \$1,642,847 paid out, \$1,502,584 by Peoples Gas and \$140,253 by North Shore (\$1,607,568 had been accrued, \$1,465,444 by Peoples Gas and \$142,124 by North Shore), under the TIA plan (NS-PGL Ex. LK-2.0, 9:181-185 (dollar amounts)) is appropriate, at a minimum, Peoples Gas should recover the \$1,009,240, and North

Shore should recover the \$94,024, that they paid out under the operational measures. NS-PGL Ex. JCH/FLV-2.0, 7:147-149.

Commission Analysis and Conclusion

[See above]

(iii) **The IPB Plan**

Other Parties

[Insert]

North Shore / Peoples Gas Response

The 2006 Individual Performance Bonus plan also applied to non-officer, non-union employees. NS-PGL Ex. JCH-1.0, 5:93-94. The performance measures under the IPB plan were not “financial”, rather each division’s senior management, with input from their managing staff, was responsible for calculating and awarding the IPB to their own employees, and, as the name of the plan indicates, the awards were based on individual performance. *Id.* at 5:95-103. Staff’s unsupported speculation that the pool for this plan might somehow be “financial” was incorrect. NS-PGL Ex. JCH/FLV-2.0, 9:183-188. The plan benefited customers by encouraging outstanding individual work performance. *Id.* at 9:190-191; NS-PGL Ex. JCH/FLV 2.2. Staff’s objection that the Utilities did not establish specific dollar savings and other tangible benefits is not reasonable given that the pool and the awards are not tied to financial performance and the IPB awards went to 426 different employees in an average amount of \$2,884.53. NS-PGL Ex. JCH/FLV-2.0, 9:197 – 10:205. Accordingly, complete recovery of the entire \$678,898 paid out, \$625,791 by Peoples Gas and \$53,107 by North Shore (\$496,910 had been accrued, \$464,408 by Peoples Gas and \$32,502 by North Shore), under the IPB plan (NS-PGL Ex. LK-2.0, 9:186-189 (dollar amounts)) is appropriate.

Commission Analysis and Conclusion

[See above]

(iv) **The STIC Plan**

Other Parties

[Insert]

North Shore / Peoples Gas Response

The 2006 STIC plan applied to senior management of Peoples Gas. NS-PGL Ex. JCH-1.0, 6:107-108. The performance measures under the STIC plan were the same as under the TIA plan, discussed above. *Id.* at 6:111-113. There were no payouts as to fiscal year 2006, but that was for unusual reasons that are not expected to reoccur. *Id.* at 6:108-110. Accordingly, complete recovery of the entire \$457,000 that was accrued, or, at a minimum, of the \$306,953 that was accrued as to the operational measures, under the STIC plan (NS-PGL Ex. LK-2.0, 9:190-194 (dollar amounts)), is appropriate.

Commission Analysis and Conclusion

[See above]

(v) **The Affiliate Charges**

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Peoples Energy Corporation charges for officers' incentive compensation and bonuses to Peoples Gas and North Shore were generally based 37.5% on operational measures. NS-PGL EX. JCH-1.0, 6:114-123. Accordingly, the entire \$744,812 charged to Peoples Gas and the entire \$165,811 charged to North Shore (Staff Ex. 2.0, Sched. 2.2P, p. 2, lines 12-13, and Sched. 2.2N, p. 2, line 12 (dollar amounts)) should be recovered or, at a minimum, 37.5% thereof.

Commission Analysis and Conclusion

[See above]

(vi) **Restricted Stock and Performance Shares**

Other Parties

[Insert]

North Shore / Peoples Gas Response

The restricted stock program was based on providing a competitive compensation package, not "financial" measures, while the performance shares program was based on "financial" measures. NS-PGL Ex. JCH-1.0, 7:131-142. Accordingly, the entire \$1,756,000 accrued (Peoples Gas only) (Staff Ex. 2.0, Sched. 2.2P, p. 2, lines 4-5 (dollar amount) should be recovered or, at a minimum, the amount of \$1,529,000 as to the restricted stock program (*id.* at line 4 (dollar amount)) should be allowed.

Commission Analysis and Conclusion

[See above]

4. Invested Capital Taxes

North Shore / Peoples Gas

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.

Other Parties

[Insert]

North Shore / Peoples Gas Response

GCI witness Mr. Effron proposed, on two grounds, to disallow the Utilities' *pro forma* adjustments reflecting the impacts on invested capital taxes of their proposed rate increases. His first ground is 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 a frivolous complaint. 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 of the relevant issues. The Utilities and Staff have made clear that the final amounts need to be recalculated based on the final approved rate increases.

Mr. Effron's second ground is his raw speculation that "it is entirely possible that an increase to operating income would lead to an increase in dividends. To the extent that any additional earnings are paid out in dividends, there will be no increase to retained earnings as a result of the increase in operating income." GCI Ex. 2.0, 35:777-780. Mr. Effron cites no factual basis for his speculation. There is none. Mr. Effron's proposal to deny recovery of invested capital taxes on the basis of such speculation is improper. *E.g., Ameropan Oil Corp. v. ICC*, 298 Ill. App. 3d 341, 348 (1st Dist. 1998) ("speculation has no place in the ICC's decision or in our review of it."); *Allied Delivery System, Inc. v. Illinois Commerce Comm'n*, 93 Ill. App. 3d 656, 667 (1st Dist. 1981) ("The speculation indulged in by the Commission is clearly an unsatisfactory and unacceptable basis for its decision."); *In re Commonwealth Edison Co.*, ICC Docket No. 99-0117 (Order, August 25, 1999), at p. 105 ("we will not make an adjustment that is speculative....").

GCI's rank speculation about increases in dividends that might affect these taxes is unwarranted. AG Init. Br. at 21-22. 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.

Commission Analysis and Conclusion

The Commission accepts Staff's and the Utilities' proposal regarding the calculation of invested capital taxes and rejects GCI's proposed disallowances. There is no evidence in the record to support GCI's suggestion that an increase to operating income could lead to an increase in dividends.

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

Staff proposes to remove non-base rate revenues and expenses in presenting the Utilities' approved operating income statement. Staff emphasizes that this is a presentation issue, not a substantive proposal. The Utilities do not oppose this proposal, provided that it is only a presentation issue, and is implemented correctly. The Commission has considered Staff's proposal in preparing the applicable Schedules in the Appendix to this Order, and [has] [has not] formulated these Schedules as suggested by Staff.

D. Derivative Adjustments from Uncontested and Contested Issues

Various of the proposed rate base and operating expenses adjustments, when their full impacts are calculated, have derivative impacts on depreciation expenses, taxes other than income taxes, and/or income taxes, as shown in the Utilities', Staff's and GCI's respective Schedules, but no party has proposed any independent adjustments to these items. Accordingly, this Order, as to the foregoing items, need only make derivative calculations reflecting the approved adjustments.

IV. RATE OF RETURN

A. Capital Structure (Uncontested)

Each Utility proposes a capital structure consisting of 56% common equity and 44% long-term debt. *E.g.*, Johnson Dir., PGL Ex. BAJ-1.0, 5:79-80. The proposed capital structures are uncontested, supported by the evidence in the record, and are approved.

B. Cost of Long-Term Debt (Uncontested)

Peoples Gas and North Shore originally proposed long-term debt costs of 4.68% and 5.42%, respectively. Johnson Dir., PGL Ex. BAJ-1.0, 2:35-38; Johnson Dir., NS Ex. BAJ-1.0, 2:35-38.

Staff and the Utilities filed testimony on this subject and, ultimately, long-term debt costs for Peoples Gas of 4.67% and for North Shore of 5.39% become uncontested. NS-PGL Exs. BAJ-2.1N and 2.1P; Freetly Reb., Staff Ex. 17.0, Schedules 17.2N and 17.2P. Those revised figures are supported by the evidence in the record and are approved.

C. Cost of Common Equity

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

North Shore / Peoples Gas

A public utility has a constitutional right to a return that is "reasonably sufficient to assure confidence in the financial soundness of the utility and [is] adequate, under efficient and

economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.” *Bluefield Waterworks & Imp. Co. v. Public Service Comm’n*, 262 U.S. 679, 693 (1923). The authorized return on equity “should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.” *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

Illinois law is consistent. The Commission “fully embraces the principles set forth” in the *Bluefield* and *Hope* cases. *In re Consumers Ill. Water Co.*, ICC Docket No. 03-0403, p. 41 (Order April 13, 2004).

Peoples Gas and North Shore each propose rates of return on common equity of 11.06%. Moul Dir., PGL Ex. PRM-1.0; Moul Dir., NS Ex. PRM-1.0; Johnson Dir., PGL Ex. BAJ-1.0, 2:35-38; Johnson Dir., NS Ex. BAJ-1.0, 2:35-38. The testimony of independent expert Paul Moul, on behalf of the Utilities, showed that this rate is justified by the financial market models that traditionally are relied on by the Commission, and that it is consistent with other indicators of investor expectations, such as the rates of return recently authorized for other natural gas utilities around the country, including the 10.51% the Commission authorized Nicor Gas Company in late 2005. *In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779, pp. 84-88 (Order Sept. 20, 2005) (“*Nicor*”).

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff and CUB-City propose costs of equity at levels far below what any sophisticated investor would expect or demand. Indeed, they are lower than this Commission has set for any gas utility in at least 30 years. Moul, NS-PGL Ex. PRM-3.0, 12:255-260 (citing ICC Financial Analysis Division’s *Rate Case Histories* (January 2005 Edition) on the Commission’s web site). The positions taken by Staff and CUB-City are marked by an overly rigid adherence to the results of their financial models, even when those results are demonstrably unrealistic, such as DCF results that approach or even fall below utility bond rates. Such rigid adherence to the models is inappropriate given the well-recognized limitations of the models to generate accurate costs of equity under all market conditions, and the subjectivity necessarily involved in their application. Moul Dir., PGL Ex. PRM-1.0, 3:63-66, 14:307-311; Moul, Tr. 1079:16-19.

The Commission has long recognized that “cost of common equity measurement techniques necessarily employ proxies for investor expectations [and] judgment is necessary to evaluate the results of such analyses. The rate of return analyst should attempt to replicate the thinking of investors, in developing their expectations regarding the growth in dividends.” *Nicor*, at pp. 86-87. “In determining what the cost of equity is for a utility, the Commission must base its decision on sound financial principles that are used by sophisticated investors. When determining whether or not to invest in the stock of a particular utility, the sophisticated investor is, in effect, setting the real cost of capital for that utility. The Commission, in authorizing a rate of return, makes an estimate of what the investor is demanding. It is the Commission that reacts

to the investor and not vice versa.” *In re Illinois Bell Tel. Co.*, ICC Docket No. 92-0448, 93-0239 (Cons.), p. 103 (Order Oct. 11, 1994) (emphasis added).

The Commission has also held that “a thorough cost of common equity analysis requires both the application of financial models and the analyst’s informed judgment. A cost of common equity recommendation based solely on judgment is inappropriate. However, because cost of common equity measurement techniques necessarily employ proxies for investor expectations, judgment is necessary to evaluate the results of such analyses.” *In re Aqua Illinois, Inc.*, ICC Docket Nos. 05-0071, 05-0072 (Cons.), pp. 52-53 (Order Nov. 8, 2005). *See also In re Central Ill. Pub. Serv. Co.*, ICC Docket Nos. 02-0798, 03-0008, 03-0009 (Cons.), pp. 83-90 (Order Oct. 22, 2003). In this regard, “the analyst’s informed judgment” must be informed by the other types of information on which sophisticated investors routinely rely, including recent regulatory decisions and market trends.

Mr. Moul offered a practical framework in which to implement the Commission’s cost of equity standards. Recognizing both the valid theoretical basis of the financial models and their limitations, Mr. Moul suggests that valid model results be used to establish the range of potentially reasonable returns, while other relevant information such as recent results from other rate cases and recent market trends be used to pinpoint the utility’s rate of return within that range. *See* Moul Tr. 1043:2-14, 1051:3 - 1052:10, 1079:15 - 1081:3.

Following this approach, Mr. Moul employed three financial models, which produced a range of results from 9.72% to 12.04%, with an average of 11.06%. Moul Dir., PGL Ex. PRM-1.0, 3:59 - 4:72. During this proceeding, Mr. Moul reviewed his recommendation and those of the Staff and CUB-City cost of equity witnesses in light of: (1) the acknowledged limitations of the market models, (2) the rates of return recently awarded other natural gas utilities in Illinois and other states, and (3) the extreme volatility in the equity markets and rising interest rates since this rate case was filed. Based on this information, he reasonably concluded that investors are currently expecting authorized rates of return on equity for natural gas utilities in the mid-10% to 11% range. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 3:60 – 4:75. While his cost of equity recommendation is at the high end of that range, Mr. Moul did not adjust his analysis to account for the increased stock market volatility and utility bond yields during the course of the proceeding. Therefore, his recommendation is a conservative one. By contrast, the recommendations of Ms. Kight-Garlich and Mr. Thomas are significantly below the range. Neither of them explained how their sub-10% positions “replicate the thinking of investors” in light of Mr. Moul’s unchallenged evidence of actual investor expectations.

Staff’s use of single-day spot stock prices in the financial models assumes that the financial markets are sufficiently efficient for daily stock prices to reflect all of the most recently available information. Staff Ex. 6.0, 29:534-535. But Staff made no showing that this is the case, while the Utilities and CUB-City demonstrated that short-term inefficiencies in the market prevent accurate stock pricing on a daily basis. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 7:153 – 8:157; Thomas, Tr. 1086:14-22, 1088:10-16. Even if Staff had made such a showing, by Staff’s own arguments a single-day spot stock price is “historical” and therefore irrelevant a day later, and certainly provides no reasonable basis for rates of return set months later. Moul Sur., NS-PGL Ex. PRM-3.0, 5:95-97, 9:203-206. Because of the volatility of daily stock prices, the

single-day spot market approach is highly susceptible to gaming, although the Utilities do not contend that Staff engaged in any such gaming in this case. *Id.*, 5:100-103.

The use of historical data ensures that the data used in the models reflects all available information, adds stability to the financial model results, and is a more objective basis for a cost of equity determination. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 8:163-165, 8:172 – 9:180; Thomas, CUB-City Ex. 2.1. Moreover, if an analyst is to apply judgment to the model results, his or her judgment must be informed by historical stock price performance, if for no other reason than that is what sophisticated investors do in the real world. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 11:230-239; Moul, Sur., NS-PGL Ex. PRM 3.0, 6:118-124.

Staff and CUB-City mischaracterize the Utilities' financial leverage adjustment to the DCF and CAPM models as a "market-to-book" adjustment of the type previously rejected by the Commission. The financial leverage adjustment does not seek to maintain a particular market-to-book ratio, but rather is a required modification to the costs of equity derived for each of the utilities in the proxy group through the financial models. Those costs of equity are based on the market value capitalizations of the proxy group utilities. When those costs of equity are applied to the proxy group's book value capitalizations used for ratemaking purposes, there is a mismatch of financial risk that renders the unadjusted model results inaccurate. Moul Dir., PGL Ex. PRM-1.0 REV, 25:539-544. A cost of equity derived from market values reflects capital structures with more equity and less financial risk, while the proxy group's (and the Utilities') book value capital structures have less equity and more financial risk. The market-based cost of equity for each of the proxy group utilities must be adjusted so that its cost of equity reflects the true financial risk of its book value capitalization. *Id.*, 28:610-612. The financial leverage adjustment in this case is 52 basis points, which is far lower than the market-to-book adjustments of 140-260 basis points that the Commission recently rejected in *Central Illinois Light Company dba AmerenCILCO*, ICC Docket 06-0070, 06-0071 (Cons.), at p. 141 (Order, Nov. 21, 2006).

Staff claims that the financial leverage adjustment lacks any basis in financial theory, yet proposes a different kind of financial risk adjustment to the market model results based on the same financial theory. Kight-Garlich Reb., Staff Ex. 18.0, 4:74-75. Staff and CUB-City variously argue that if the market value of a utility's equity is higher than its book value, the financial leverage adjustment will allow the utility to over-earn. *Id.*, 33:626 – 34:642; Thomas Dir., CUB-City Ex. 1.0, 32:786 – 33:787. Staff did not substantiate its position that there can be only two reasons why the Utilities' market-to-book ratios are greater than 1.0 (the investor-required rate of return has fallen or expectations of future earnings have risen). Moul Reb., NS-PGL Ex. PRM-2.0 REV, 20:425-442. And, by Staff's admission, there are factors unrelated to investor expectations, including ratemaking practices, that can lead to such ratios. *Id.*, 19:411-413; 28:612-619; Kight-Garlich Reb., Staff Ex. 18.0, 19:374-382. Staff's objections to the financial leverage adjustment are inconsistent and contradictory.

Staff's "financial risk" adjustment to the financial model results is based on the same financial theory as Mr. Moul's "financial leverage" adjustment, but is based on an inappropriate comparison of the Utilities' credit ratings to the credit ratings reflected by the proxy group. Kight-Garlich Dir., Staff Ex. 6.0, 17:326 – 22:412. This comparison is not appropriate because Staff accepted the Utilities' proxy group as having a comparable balance of risks to the Utilities, including consideration of credit ratings. Staff cannot claim that lower financial risk as reflected

by credit ratings requires an adjustment of the financial model results without demonstrating that the difference is not offset by increased risks with respect to the other parameters on which the proxy group was based, which included percentage of assets dedicated to gas operations, credit ratings, size, market-based financial ratios, book common equity ratio, variability of returns on book equity, operating ratios, fixed charge coverages, quality of earnings, internally generated funds for construction, and beta coefficients of systematic risks. Moul Dir., PGL Ex. PRM-1.0 REV, 8:162 – 13:286. The very intent of a proxy group is to assemble a group publicly traded companies which on balance have a comparable level of risk as the utility. See Moul Dir., PGL Ex. PRM-1.0 REV, 14:288-296. Either the proxy group is a proxy, or it is not. Staff cannot have it both ways.

In objecting to CUB-City's proposed market risk premium for the CAPM model, Staff argues that the Commission sets cost of equity based on what investors "truly are expecting," and not what they "should expect." Kight-Garlich Dir., Staff Ex. 18.0, 20:407-409. But, as the Utilities point out, instead of basing the CAPM beta measurement on published analyst's betas that investors actually rely upon, such as those available from *Value Line*, Staff insists on calculating its own betas. These betas by definition cannot be relied upon by investors, and therefore represents an attempt by Staff to base the cost of equity on what investors should expect instead of what they do expect. Moul Dir., NS-PGL Ex. PRM-2.0 REV, 15:327 – 16:338. The same is true of CUB-City's advocacy for the use of "raw" betas, the use of which the Commission has already determined "would cause a downward bias in cost of equity estimates." *CILCO 2006*, at p. 144.

Staff's and CUB-City's shared position that the Utilities' ROEs must be reduced if the proposed Riders VBA and UBA are approved is unsupported and illogical. Neither Staff nor CUB-City rebutted the Utilities' demonstration that the existence or non-existence of such riders does not affect a utility's cost of equity. Moul Dir., PGL Ex. PRM-1.0 REV, 5:105 – 7:137. Even if they did, with seven of the nine gas utilities in the proxy group already having revenue decoupling mechanisms, logic insists that the Utilities' authorized returns be increased if the riders are not approved. Moul Reb., NS-PGL Ex. PRM-2.0 REV, 22:473-483. Staff's analysis of the riders' potential effect on the Utilities' credit ratings is unsubstantiated, as Staff failed to demonstrate that S&P would change its business profile score for the Utilities by a full notch to two due to the approval of the revenue decoupling riders. CUB-City's attempt to show a financial impact of the riders based on weather insurance previously purchased by the Utilities' corporate parent is irrelevant because the analysis is based on the faulty premise that the value of an insurance policy is its maximum payout net of the premium (as opposed to the premium itself). It also fails to model the risk increase associated with the riders' "payout" to ratepayers in the event of colder-than-forecasted weather. Schott Reb., NS-PGL Ex. JFS-2.0, 6:111-112; Thomas, Tr. 1099:15 – 1101:19.

In addition to ignoring recent returns authorized gas utilities by this Commission and other state commissions, the ROE positions of Staff and CUB-City do not reflect the surge in stock market volatility and utility bond yields that occurred during this proceeding. Stock price volatility is at its highest level since 2003. Moul Sur., NS-PGL Ex. PRM-3.0, 2:26 – 5:97. Utility bond yields have risen to their 5-year high. Moul Reb., NS-PGL Ex. PRM-2.0, 3:46-59; Moul, NS-PGL Ex. PRM-2.1. ROEs being set in early 2008 must reflect consideration of these recent market trends.

The Utilities' proposed rate of return on common equity of 11.06% should be approved. Their proposed rate, unlike the proposals of Staff and CUB-City, is consistent with the evidence in the record and the applicable legal principles.

Commission Analysis and Conclusion

The large differences in the parties' positions on cost of equity, all based on similar financial cost of equity models, demonstrate once again to the Commission that its determination of a utility's cost of equity cannot rely on rigid adherence to the model results. Each of the models has its own limitations, and their application involves the subjectivity of the analyst. The Commission therefore reaffirms that a thorough cost of common equity analysis requires both the application of the financial models and the analyst's informed judgment.

The parties' debate regarding the consideration of information other than the financial model results provides the Commission with an opportunity to consider the types of information that should inform the analyst's judgment. As the Commission has noted in prior cases, the expectations of the sophisticated investor drive the determination of a utility's cost of equity. In making rate of return decisions, the Commission estimates what the investor is demanding, not what the investor should demand. The types of information relevant to this inquiry are, therefore, the same types of information available to and relied upon by sophisticated investors when they are deciding whether or not to invest in the stock of a particular utility.

The Utilities' cost of equity witness, Mr. Moul, argues convincingly that sophisticated investors consider historical information as well as current and forecasted data when applying the financial models, and that the Commission's past practice of basing the application of the financial models on single-day spot market data may not provide accurate costs of equity due to volatility and other short-term inefficiencies in the financial markets. The Commission also shares Mr. Moul's concern that basing a cost of equity decision months after the single-day spot market data was collected creates the very real possibility, if not probability, that the decision will reflect data that is unreasonably out of date and no longer relevant. By contrast, the use of historical data in the financial models may provide a more objective and stable reflection of the financial parameters that affect cost of equity. The Commission determines that the use of historical data in applications of the financial models is acceptable, provided that the analyst demonstrates that the data remains relevant to the establishment of the utility's cost of equity and that the historical period was not subjectively chosen to skew the result.

The Commission also agrees with Mr. Moul that other information relied upon by investors in addition to the financial model results, including returns granted other utilities by this Commission and other state commissions, as well as general trends in the financial markets that may affect a utility's cost of equity, are relevant considerations. This Commission will not base its cost of equity decisions on the results of other rate cases, because to do so would be hopelessly circular. But the Commission finds that other cost of equity decisions are a useful benchmark for comparison to the financial model results. Large differences between the two could suggest the need to reconsider the models or how they were run. Likewise, it is important for the analyst and the Commission to continue to gather information on the financial market throughout a rate case proceeding in order to ensure that the Commission has reasonably current information on which to base its cost of equity decisions. According to evidence presented by

Mr. Moul that was not rebutted by Staff or CUB-City, volatility in the stock market increased sharply in 2007, and utility bond yields increased significantly to their five-year high. This evidence must be considered in determining the Utilities' cost of equity for 2008.

The Commission has carefully evaluated the Utilities' proposed "financial leverage" adjustment and finds it to be a required adjustment to financial model results that are based on a utility proxy group. The adjustment is well grounded in financial theory. Although the market-to-book ratio adjustments previously rejected by the Commission purportedly were based on the same mismatch between the financial risk reflected in the market-based cost of equity generated by the financial models and the financial risk reflected in the utility's book value capital structure, those adjustments sought to cure the mismatch indirectly by maintaining a target market-to-book ratio. The Utilities' proposed financial leverage adjustment addresses the mismatch directly and applies regardless of the utility's market-to-book ratio. With the financial leverage adjustment, the cost of equity applied to the utility's book value capitalization will generate the earnings that reflect its financial risk, nothing more and nothing less.

The "financial risk" adjustment presented by Staff has been accepted by the Commission in prior rate cases. The Commission finds that this adjustment is based on the same financial theory that underlies the financial leverage adjustment, and therefore continues to have conceptual merit. However, the Utilities have established a valid objection to an adjustment to the financial model results for one of the many risk factors that go into the compilation of a proxy group, without a demonstration that the single risk differential is not offset by other risk differentials. The Commission in the future will consider financial risk adjustments based on comparisons of a utility's credit rating to the credit ratings reflected in the proxy group only upon a showing that the difference in financial risk is not offset by other risk differentials between the proxy group and the utility.

For the above reasons, the Commission finds that Mr. Moul's application of the financial models provides the most accurate estimation of the Utilities' cost of equity. In reaching that conclusion, the Commission has considered the financial model results presented by the parties, the data underlying those results, recent and relevant decisions on cost of equity by this Commission and other state commissions, and recent market trends. The Commission finds the proposals of Staff and CUB-City to be unrealistically low. The Commission notes that while Mr. Moul identified recent market trends that would tend to increase the Utilities' cost of equity, he did not adjust his recommendation to reflect those trends. Thus, Mr. Moul's estimate of 11.06% represents a conservative estimate of the Utilities' cost of equity and is therefore just and reasonable.

Because the Commission approves Riders VBA and UBA, it must determine whether the Utilities' authorized returns on equity must be adjusted to reflect reduced risk, as Staff and CUB-City have advocated. The Commission notes first that the riders are risk neutral in the sense that either rider can produce a charge that reduces the utility's risk or a credit that reduces the ratepayer's risk. The Commission also concludes that neither Staff nor CUB-City have demonstrated that the existence or non-existence of revenue decoupling riders affects a utility's cost of equity. The Commission also finds each party's proposed methodology of measuring that effect to be speculative. The Commission further finds that CUB-City's estimation of the value of Rider VBA comparing it to a weather insurance policy previously purchased by the Utilities'

corporate parent has no basis in theory or the facts. The estimate erroneously values the insurance policy based on its net maximum payout. The economic value of an insurance policy is reflected in the premium, which reflects consideration of the probability of payout. In addition, CUB-City's estimated value fails to recognize the risk neutral nature of the rider. For all of these reasons, there is no basis in this record for the Commission to conclude that approval of Riders VBA and UBA will decrease the Utilities' cost of equity.

D. Flotation Costs

North Shore / Peoples Gas

Peoples Gas and North Shore witness Mr. Moul included in each of his market model results a standard adjustment for the "flotation" costs associated with the issuance of new common stock, namely the underwriting discount and company issuance expenses. Moul Dir., PGL Ex. PRM-1.0, 28:625-631, 36:795-796, 41:891-892; *see* PGL Ex. PRM-1.13D, 1:403-404. Mr. Moul based his 19-point adjustment on the 3.9% average flotation costs incurred by the utilities in the utility sample during the period 2001-2005. *Id.*, 2:425 - 3:433; PGL Ex. PRM-1.8.

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff witness Ms. Kight-Garlich, citing prior Commission decisions, argue that the Utilities had to prove that they would issue stock in the test year or that their incurred flotation costs were not recovered previously through rates. Kight-Garlich Dir., Staff Ex. 6.0, 26:479 – 27:497. However, she ignored that the Utilities provided evidence of the flotation costs they previously have incurred and not recovered through prior rates, totaling \$485,000 each. NS Ex. BAJ – 1.3; PGL Ex. BAJ – 1.3. Therefore, the Utilities' adjustment should be approved. If the Commission does not adopt Mr. Moul's flotation cost adjustment, then it should at least authorize an adjustment that allows the Utilities to recover their unrecovered flotation costs.

Commission Analysis and Conclusion

The Utilities' proposed flotation cost adjustment is supported by the evidence and is approved. The Companies proved their flotation costs.

Alternative

The Commission does not approve the Utilities' proposed flotation cost adjustment, but the Companies proved their flotation costs. Therefore, the Commission approves inclusion of these costs in the calculation of the Utilities' revenue requirements.

E. Weighted Average Cost of Capital

1. Peoples Gas

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital for Peoples Gas of 8.24%, calculated as follows:

Peoples Gas Cost of Capital Summary			
Cost of Capital	Percent of Total	Percent Cost	Weighted Cost
Long Term Debt	44.00%	4.67%	2.05%
Common Equity	56.00%	11.06%	6.19%
Total Capital			8.24%

2. North Shore

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital for Peoples Gas of 8.56%, calculated as follows:

North Shore Cost of Capital Summary			
Cost of Capital	Percent of Total	Percent Cost	Weighted Cost
Long Term Debt	44.00%	5.39%	2.37%
Common Equity	56.00%	11.06%	6.19%
Total Capital			8.56%

V. HUB SERVICES (All Issues Relating to Hub Services)

The Hub is a group of interstate gas transmission and storage services available to wholesale customers. Hub services are made available by Peoples Gas using portions of the capacity at Peoples Gas' underground storage facility, Manlove Field, and Mahomet Pipeline. Peoples Gas charges the customers that use these Hub services at rates approved by the Federal Energy Regulatory Commission, and the resulting revenues are credited to retail customers through the purchased gas adjustment clause (Rider 2). The revenue benefit credit to the Hub is a benefit to all sales customers on the utility system.

Staff, through its witnesses Dennis Anderson and David Rearden, argues that the Hub actually loses money, and is therefore imprudent to operate.

A. Manlove Field

Peoples Gas

Manlove Field an underground aquifer, that is, porous rock with water in the pores. PGL Ex. TLP-1.0, 3:47-55. Manlove Field is particularly complex, even as aquifer storage fields go.

PGL Ex. TLP-1.0, 4:69-84. Manlove is large, inefficient (*i.e.*, a relatively high percentage of gas becomes trapped), and difficult to manage and characterize. PGL Ex. TLP-1.0, 3:61-62; Tr. at 472:14-15; 492:3-8. This feature and the fact that the field has been used for gas storage operations for years renders it difficult to ascertain which areas of the aquifer are virgin aquifer and what areas have trapped gas. It is also difficult to determine whether new injections will invade virgin aquifer or previously invaded areas. PGL Ex. TLP-3.0, 10:211-220.

When Peoples Gas introduced the Hub services, it did not install additional wells or other facilities to enable it to provide the service. It merely expanded the amount of working gas at Manlove by injecting more gas into the storage field and increased working gas by 10.2 Bcf. Staff Ex. 10.0, 6:111-117.

In all, from 1997 through 2006, Peoples Gas capitalized an additional 7.88 MMDth of its Manlove injections as cushion gas. *Id.* at 11:225-228. Based on the various metrics used by Peoples Gas to assess the storage field's performance, this is keeping Manlove Field operating as expected. PGL Ex. TLP-2.0, 7:156 - 9:193.

Peoples Gas did not inject additional cushion gas at the time it started offering Hub services. What Peoples Gas has done instead is to characterize a percentage of the gas it injects each day during the injection season as cushion gas. PGL Ex. TLP-1.0, 10:221-224. Some of that annual cushion gas allotment is supporting Hub operations, and the rest is supporting general storage operations at Manlove. PGL Ex. TLP-3.0, 6:132-7:149. Peoples Gas estimates the amount of cushion gas that would be attributed to the Hub storage to be approximately 1.34 MMDth. PGL Ex. TLP-2.8.

Staff

[Insert]

Peoples Gas Response

Peoples Gas asserts the Staff is mistaken in assuming that Peoples Gas expanded Manlove Field's working gas by 8 Bcf all in the first year. In that first year (1998), Hub inventory was just 1.5 Bcf, and did not go above 8 Bcf until 2002. While the cornerstone of Staff's argument is that the sudden large increase of working gas should have been accompanied by a large injection of cushion gas, the expansion of Hub services was much more gradual. PGL Ex. TLP-2.8. It was therefore quite reasonable, says Peoples Gas, to continuously inject cushion gas to support all operations at Manlove Field, as opposed to a single large injection. Over the 40 years Manlove has been in existence, Peoples Gas has injected a great deal of gas into the field as base gas. Gas slowly creeps outward over time, invading new areas. When Peoples Gas began gradually increasing its working gas to enable Hub operations, it was initially able to do so with the support of base gas already underground. To support all storage operations, including both Hub and other storage, Peoples Gas then added base gas going forward at the rate of 3.5%, and this has proved adequate to keep the field operating properly.

According to Peoples Gas, if it is injecting too little cushion gas, Peoples Gas would notice, over a relatively short time, that Manlove was not performing properly. Tr. at 485:1-5.

In operating an aquifer storage field, the operator watches various metrics such as pressure and peak deliverability, to see if the field is operating as expected (Tr. at 485:20-486:6), and that is just what Peoples Gas has done. When, after fixing a metering problem, Peoples Gas was inadvertently under-injecting cushion gas by a shortfall of just 0.6 MMDth per year, Peoples Gas noticed a significant drop-off in field performance; and when Peoples Gas increased its injections to approximately their previous levels, field performance promptly returned to normal. PGL Ex. TLP-2.0, 7:136-8:168. Peoples Gas points to this as proof that, if Staff were correct that Peoples Gas has been severely under-injecting cushion gas, Peoples Gas would see it in the performance of the field. Since field performance has been quite good in the last several years, Peoples Gas' capitalized cushion gas injections of 7.88 MMDth have been sufficient.

Commission Analysis and Conclusion

As to the operations at Manlove Field, the Commission must decide whether Peoples Gas has been making sufficient injections of cushion gas to support its operations. Based on Peoples Gas' evidence that it has been monitoring field performance, with no fall-off in performance since it has been continuously injecting 3.5% cushion gas, we find that Peoples Gas' cushion gas injections have been reasonable. In total, the capitalized injections since Peoples Gas' last rate case total 7.88 MMDth of gas.

Staff is correct that Peoples Gas did not inject new cushion gas to support Hub services at the time Peoples Gas initially began offering those services. However, Staff concedes that Peoples Gas could choose to add cushion gas gradually and continuously to support the expanded use of Manlove Field. Staff Init. Br. at 97. Peoples Gas has gradually increased its use of Manlove Field for Hub services, while continuing to inject cushion gas to support the overall operation of the field. With the exception of a short period during which cushion gas injections were decreased, following which Peoples Gas noticed a drop in field performance and increased injections, the field has been operating normally. This indicates to the Commission that the cushion gas injections reported by Peoples Gas have been sufficient.

For the purposes of considering Staff's contention that offering Hub services was imprudent, the Commission finds that Peoples Gas' calculation of 1.34 MMDth of the total 7.88 MMDth of cushion gas injections is reasonable. PGL Ex. TLP-2.8 provides this calculation, and is the only credible evidence in the record. The Commission finds Staff's hypothetical calculation that the Hub required 45.3 Bcf of base gas, based on the "historical ratio" of working gas to base gas, not reasonable.

B. Hub Services

Peoples Gas

Peoples Gas' Hub services are comprised of two types of FERC-jurisdictional services. First, the Hub includes the transportation and storage provided by Peoples Gas pursuant to a FERC Operating Statement. Second, it includes other interstate services provided pursuant to FERC's rules authorizing sales for resale at negotiated rates. Zack Reb., NS-PGL Ex. TZ-2.0, 65:1458-1461.

Peoples Gas received a Hinshaw Blanket Certificate in March, 1998 (*The Peoples Gas Light and Coke Company*, 82 FERC ¶62,145 (1998)) and the initial Operating Statement which included only transportation services was approved by the FERC in March, 1998 (*The Peoples Gas Light and Coke Company*, 82 FERC ¶61,239 (1998)). The FERC approved the filing with storage and parking and loaning services in March 1999 (*The Peoples Gas Light and Coke Company*, 86 FERC ¶61,226 (1999)). Service began immediately following the receipt of the operating approval. *Id.* at 66:1463-1467.

Hub rates associated with the services provided under the Operating Statement are developed and set according to the FERC rules. The most recent rates were established in FERC Docket No. PR07-1-000 and approved by FERC in March, 2007. *The Peoples Gas Light and Coke Company*, 118 FERC ¶61,203 (2007); *See also* Zack Reb., NS-PGL Ex. TZ-2.0, 66:1476-1477. The rates for the other Hub services are established through negotiations with the counter parties and by means of a competitive bidding process in which the highest bidder wins. *Id.* at 66:1475-1478, Zack, Tr. at 512:5-19.

Peoples Gas has credited (or will be crediting following an order in its fiscal 2005 as cost reconciliation case) to the Rider 2 Gas Charges over \$20 million in 2005 and 2006 alone for the gross revenues from the Hub. In addition, as part of the resolution of Peoples Gas' fiscal years 2001-2004 Gas Charge case, the Commission determined that issues concerning the treatment of Hub revenues for those years were properly included in the refund that the Commission ordered. Additionally, Hub revenues are forecasted to reach \$13 million in 2007. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1541- 70:1551; Zack, Tr. at 516:9-10.

Staff

[Insert]

Peoples Gas' Response

Staff argues that it was imprudent for Peoples Gas to offer Hub services and that the cost of expanding the Hub services should not be recovered in rates because Peoples Gas never conducted written studies to determine the prudence of expanding of Manlove Field and never received prior approval from the Commission pursuant to Section 7-102(A)(g) of the PUA before expanding the Hub. 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. 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 not imprudent.

Peoples Gas offers Hub service as a means to more efficiently utilize the existing Manlove and Mahomet pipeline assets and to provide customer benefits. Hub services provide customer benefits in three ways: (1) through credits to the Gas Charge (which is implemented in Rider 2 of the Tariff); (2) by extending the Manlove decline point (as defined below); and (3) by increasing market liquidity at the Chicago citygate. Zack Reb., NS-PGL Ex. TZ-2.0,66:1469-1473.

Peoples Gas provides a benefit to customers by extending the Manlove Field decline point. Staff argues that Peoples Gas has failed to provide any studies or other documentation to support the extension of the Manlove Field decline point.

The additional Hub volumes serve to extend the decline point. Extending the decline point of Manlove means extending the capability of the field to perform full peak withdrawal throughout the winter season. The operation of the Hub causes the injection of more gas into Manlove Field, which extends the field decline point, which, in turn, extends how long Manlove Field is useful for storage and capable of full peak withdrawal. Since all Hub volumes are contractually required to be withdrawn, they bring with them the benefit of the higher volumes without the risks associated with a warm winter. Puracchio Reb., NS-PGL Ex. TLP-2.0, 100 13:278-288.

To verify the Manlove Field decline point, Roxar, Inc. prepared a report in July, 1999 that showed the decline point extending as working gas increased. NS-PGL Ex. TLP-2.9. Also, the 2003 and 2005 Connaughton Reports each contains a discussion of the extension of the decline point. Puracchio Reb., NS-PGL Ex. TLP-2.0, 14:290-292; NS-PGL Ex. TLP-1.1. So, the benefit to ratepayers comes in the form of access to the full daily peak withdrawal capability of Manlove Field longer into the winter season.

The Commission in Docket No. 01-0707 did not find that the decline point had not been extended through the additional gas associated with the Hub, nor did it make any finding regarding whether the decline point extension was an operational benefit. The Commission's finding on the decline point was that the additional gas which supported the decline point extension did not directly benefit customers because the profits from the third party services were not being passed to customers. *Illinois Commerce Comm'n v. Peoples Gas*, Docket 01-0707 (March 20, 1996), Final Order at 93.

As to increasing market liquidity at the Chicago city gate, the Hub activity increases liquidity at Peoples Gas' city gate specifically and more generally in the Chicago area market. In particular, all the gas supporting Hub activity must come to one of Peoples Gas' city-gate locations to be a Hub transaction. This increases the amount of gas delivered to Peoples Gas on a daily basis. Therefore, the more gas brought to the Chicago city gate as a result of the operation of the Hub, the greater the benefit to all customers. This provides all customers access to a greater amount of gas than would otherwise be available if there was no Hub activity. Zack Reb., NS-PGL Ex. TZ-2.0, 70:1553-1558. Increasing market liquidity creates downward pressure on gas prices. Staff does not respond to benefits provided ratepayers by increasing market liquidity and creating a downward pressure on gas prices.

Since the Hub came into existence, all of its expenses, including and consisting primarily of over \$7 million of incremental compressor fuel costs have been borne by Peoples Gas. None of those costs were paid by Peoples Gas' customers. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1538-1540. The Hub rate design included Manlove's base gas requirements and these costs were included in the cost of service study used to support the Hub filing before the FERC. *The Peoples Gas Light and Coke Company*, 82 FERC ¶ 62, 145 (1998); 82 FERC ¶ 61, 239 (1998); 86 FERC ¶ 61, 266 (1999) ; 118 FERC ¶61,203 (2007). These costs were then used to develop the rates for Hub services under the Operating Statement. Id. at 68:1505-1507. The expansion of

Manlove Field did not involve the use of Gas Charge assets or the use of assets in which costs were being recovered through base rates. All incremental expenses associated with the Hub were absorbed by Peoples Gas. Zack Reb., NS-PGL Ex. TZ-2.0, 67:1490-1496.

Moreover, the storage expansion for the Hub began years after Peoples Gas' last rate case. The base rates approved in Peoples Gas' last rate case proceeding (ICC Docket No. 95-0032) therefore reflected a test year that was prior to the expansion of Manlove Field. *Id.* See also Grace, Reb., NS-PGL Ex. VG-2.0, 57:1261-1263. Peoples Gas now seeks to recover these costs through the instant rate hearing.

Staff's proposed disallowance of all costs associated with the Hub is improper. Dr. Rearden found that the Hub revenues are estimated to be \$10-\$12 million per year. Rearden Dir., Staff Ex. 12.0, 22:473-474. Using his improper methodology, Dr. Rearden found that Hub costs per year were \$13.3 million, made up of the capital costs of the supposed additional cushion gas plus operations and maintenance expense. Rearden Dir., Staff Ex. 12.0, 26:559-560. Since \$13.3 million is more than \$10-\$12 million, he concluded that the Hub is imprudent. However, even accepting Dr. Rearden's numbers, which Peoples Gas does not, the revenue requirement should be reduced by \$1.3 million to \$3.3 million per year, the difference between the cost of \$13.3 and the revenues of \$10-\$12 million dollars. Instead, Dr. Rearden proposes to eliminate all the rate base and operations and maintenance expense associated with the Hub, while leaving all the revenues in to reduce future gas costs. Rearden Dir., Staff Ex. 12.0, 30:617-636. If the Commission were to find the Hub imprudent, then the proper result would be to reduce the revenue requirement no more than \$1.3 – \$3.3 million. See Zack Reb., NS-PGL Ex. 2.0, 71:1584-1588.

Prior to the final order in Commission Docket No. 01-0707, all the costs and revenues associated with the Hub and the base rate assets that support the Hub are accounted for above the line. Subsequent to the Docket No. 01-0707 order, all the revenues were flowed through the Gas Charge. Zack Reb., NS-PGL Ex. TZ-2.0, 70:1551-1552. Since the Hub came into existence, all of its expenses, including and consisting primarily of over \$7 million of incremental compressor fuel costs have been borne by Peoples Gas. None of those costs were paid by Peoples Gas' customers. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1538-1540. Finally, the only incremental capital cost attributable to the Hub is cushion gas which is discussed above under A. "Manlove Field".

The customer benefits provided by the Hub have exceeded, and are expected to continue to exceed, the costs of providing these services. Therefore, Peoples Gas should continue to provide Hub services for the benefit of its customers. Zack Sur., NS-PGL Ex. TZ-3.0 REV, 43:945-948. When asked what a net benefit to ratepayers is as it pertains to the Hub, Staff Witness Dr. Rearden's response was, "[r]evenues of – either cost savings or revenues greater than costs". Dr. Rearden, Tr. at 674:1-4. Using Staff's simple definition, it is clear that Hub operations are a net benefit to the Peoples Gas system and its ratepayers.

Commission Analysis and Conclusion

The Commission rejects Staff's arguments and finds that the expansion of Manlove Field is not imprudent. 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. The Commission also finds that properly allocating the cost of the base gas supporting Hub operations, the Hub's revenues easily exceed costs. NS-PGL Ex. TZ-2.07. The cost of base gas is shared by Hub customers, but all the revenues credited to the customers through the Purchased Gas Adjustment. Zack Reb., NS-PGL Ex. TZ 2.0, 68:1520-1524.

Staff's argument is that Peoples Gas' Hub services are imprudent because the costs outweigh the revenues. Staff Init. Br. at 111. Yet, it is uncontested that, pursuant to the Commission's Order in Docket 01-0707, all revenues from Hub services are credited to Peoples Gas' customers through reductions its Rider " 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. The Commission finds that Peoples Gas has complied with the Commission order crediting to Rider 2 gross revenues from the Hub. Notwithstanding Staff's argument to the contrary, the Commission agrees that the Hub provides more benefits than costs. Hub revenues have exceeded \$10 million annually and they are expected to exceed that amount in 2007. Zack Reb., NS-PGL Ex. TZ-2.0, 70:1547-1551. As such, the Commission agrees that it would be harmful to customers to eliminate the Hub. The Commission finds the Staff's reasoning unpersuasive and without support in the record. For all of the reasons discussed herein, the Commission agrees that the Hub is a net benefit to Peoples Gas' customers and should not be eliminated.

The Commission rejects the Staff's argument regarding the Manlove Field decline point. The Commission agrees that the additional volumes of gas do serve to extend the decline point of Manlove Field. The reports entered into the record, the Roxar Inc. report of 1999 and the Connaughton Reports of 2003 and 2005 have not been contested, and the studies indicate an extension of the decline point. The Commission finds that the extension of the Manlove Field decline point is a benefit to all customers of Peoples Gas.

The Commission finds that the Hub activity does increase liquidity at the Chicago-city gate and as a result of such activity and the availability of more volumes of gas, there is a theoretical downward pressure on gas prices due to the Hub activity. The Commission finds the downward pressure created because of Hub activity a benefit to all customers.

Staff has raised the concern that Gas Charge assets have been used to subsidize Hub services. The Commission finds all of the Hub expenses, including and consisting primarily of over \$7 million of incremental compressor fuel costs have been borne by Peoples Gas. None of those costs are recovered through the Gas Charge and none were paid by Peoples Gas' customers. Zack Reb., NS-PGL Ex. TZ-2.0, 69:1538-1540. The Commission finds that the record is devoid of any evidence that Peoples Gas has utilized any of the Gas Charge assets to subsidize Hub services. We agree the storage expansion for the Hub began years after Peoples Gas' last rate case. The base rates approved in Peoples Gas' last rate case proceeding (ICC Docket No. 95-0032) therefore reflected a test year that was prior to the expansion of Manlove Field.

The Commission finds that the methodology employed by Staff is flawed for reasons stated earlier. Staff's urging that all capitalized base gas proposed to be added to rate base and operations and maintenance expense associated with the Hub are improper and not supported by

the record is clearly overreaching. The Commission agrees that even if Staff's estimate of Hub costs of \$13.3 million could be supported, which they cannot, the revenue requirement could only be reduced by \$1.3 million to \$3.3 million per year.

As to the issue of prior approval, the Commission finds that Peoples Gas was not required to acquire prior approval to expand working gas at Manlove Field. Section 7-102(A)(g) of the PUA does not apply here. 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 or division of the utility business. Section 7-102(A)(g) would only be applicable to the Hub if it were unconnected to distribution, storage and sale of gas i.e., "the business of such public utility". That is not the case. Moreover, the Commission considered Peoples Gas' Hub services in Docket 01-0707, and issued certain directives as to the proper accounting for the costs and revenues. So long as Peoples Gas abides by the Commission's order, the Commission need not reconsider Peoples Gas' authorization.

C. Hub Procedures

Staff

[Insert]

Peoples Gas' Response

Staff witness Mr. 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. TZ-3.0 REV, 38:837-839.

Staff has subsequently agreed that the report should be received in 120 days. This matter is no longer contested.

Commission Analysis and Conclusion

Given the Staff's agreement, the Commission orders Peoples Gas to submit to the Director of the Energy Division within 120 days of the Commission's final order in this proceeding procedures to document how Peoples Gas allocates Manlove storage capacity and how it ensures that ratepayers are not harmed by its allocation decisions.

VI. WEATHER NORMALIZATION – AVERAGING PERIOD

The Utilities' gas deliveries, and therefore revenues, are highly dependent on weather. A comparison of the Utilities' sendout of gas with the key weather statistic reflecting use of gas for space heating, the "heating degree day" (or "HDD"), reveals a close correlation between cold temperatures and gas deliveries.¹ Similarly, over the course of a heating season, a colder winter results in more, and a warmer winter results in less, deliveries. One of the key factors in calculating the gas deliveries billing determinants is the projected level of heating degree days for a normal year during the period in which the rates are in effect. Weather normalization is a method of projecting expected gas deliveries based on normal weather for a utility's service area and building it into the rates. The Utilities' delivery service rates have a substantial volumetric component. Therefore, it is important to establish rates, based on the appropriate weather normalized gas deliveries, that will not result in revenues that would be materially higher or lower than those approved by the Commission. PGL Ex. VG 1.0 2REV, 51:1122-1135; NS Ex. VG 1.0 3REV, 45:984-997. No party disputes this, nor disputes the concept that weather normalization is appropriate for setting the Utilities' rates. The dispute raised by GCI centers on the calculation of the normal weather – the predicted number of heating degree days – that the Utilities can expect. In the Utilities' 1995 rate cases, the Commission approved weather normalization based on a thirty-year average of heating degree day statistics. The Utilities have proposed here that their heating degree day billing determinant be the average of the actual annual heating degree days experienced over the most recent ten calendar years prior to the filing of these rate cases.

North Shore / Peoples Gas

The Utilities have proved, based on an analysis of all the weather statistics available, that compared to using an average of the past thirty years, an average of the past ten years will more accurately predict the heating degree days over the next several years, during which time the Utilities' proposed rates are expected to be in effect. The Utilities presented the testimony of Mr. Brian Marozas, an expert in statistics, who analyzed how predictive a ten-year average is compared to a thirty-year average. He found that the ten-year average is significantly more accurate in predicting future heating degree days. PGL Ex. BMM-1.0, 4:79 through Table 1; NS Ex. BMM-1.0 4:79 through Table 1.

The Utilities have shown that the winter climate in their service territories has begun to warm, and is expected to continue to do so over the next several years. A climate scientist, Prof. Eugene Takle, showed that Mr. Marozas' statistical results are consistent with the current scientific consensus on climate change. PGL Ex. EST-1.0, 33:712-716; NS Ex. EST-1.0, 33:711-715. The changing climate makes a shorter averaging period more accurate than a longer period, which has many years of data from the less relevant colder regime. PGL Ex. EST-1.0,

¹ The number of HDDs is the number of degrees Fahrenheit that the actual mean daily temperature is below 65 degrees Fahrenheit. Takle Dir., PGL Ex. EST-1.0, 7:139-151; Takle Dir., NS Ex. EST-1.0, 7:138-150.

32:701-702; NS Ex. EST-1.0, 32:700-701; *see also* PGL Ex. BMM 1.0, 7:127-134, and NS Ex. BMM 1.0, 7:127-134.

Mr. Marozas' study analyzed all available data since the O'Hare weather station began collecting statistics, found that using a rolling ten-year average produces less error than a thirty-year average in predicting the next year out, as well as years two, three, four, and five. NS-PGL Ex. BMM-3.0, 2:22 – 3:46. The Utilities assert that the warming climate counsels against using data from thirty or more years ago that is not representative of today's climate. PGL Ex. EST-1.0, 32:700-711; NS Ex. EST-1.0, 32:699-710. The Utilities criticized the NOAA long-term thirty-year average as a particularly poor predictor. As described by Professor Takle, a group of Illinois climatologists studied averaging periods several years ago and concluded that the NOAA thirty-year average was one of the worst predictors of any averaging method they tested. PGL Ex. EST-1.0, 30:651-655; NS Ex. EST-1.0, 30:650-654; NS-PGL Ex. EST-2.0, 5:103 – 6:115. Professor Takle also noted that, based on his review of an upcoming article accepted for publication in a scholarly journal, at least some NOAA scientists now take the position that the old thirty-year normal is no longer appropriate. NS-PGL Ex. EST-3.0, 2:38 - 3:53.

If neither Rider VBA nor Rider WNA are approved, the effect of using an appropriate weather normalization period is essential if Peoples Gas' and North Shore' rates are to be fair. If the Commission were to impose the most recent thirty-year average, as it did in 1995, or the GCI's proposed NOAA average, it will cause the Utilities' rates for recovering the allowed base rate revenue requirement to be set too low for the number of heating degree days that the Utilities' service territories are likely to experience. They say this will prevent the Utilities from recovering the revenue amounts authorized by the Commission. NS-PGL Ex. 2.0, 25:524-539.

GCI

[Insert]

North Shore / Peoples Gas Response

The Utilities point out that the GCI have completely failed to show, through statistics or science, why their proposal to use the average of the years 1971-2000 is superior to the Utilities' proposed 10-year average. The Utilities' statistical analysis demonstrated that the 10-year average predicts one, two, three, four, and five years into the future with lower statistical error than the NOAA 30-year average, or the average of the most recent 30 years. Using weather from years so long ago, prior to the current warming trend, would also not be consistent with the consensus views of climate scientists.

The fact that other averaging periods, just shorter and longer than 10 years, have slightly lower statistical errors does not disqualify the use of a 10-year average, the Utilities claim. Mr. Marozas, the Utilities' statistician, showed that the periods with the lowest errors clustered around 10 years. All of these averaging periods have significantly lower statistical errors than either of the 30-year averages. Using ten years, the same methodology as neighboring Nicor Gas, provides an ancillary benefit.

Commission Analysis and Conclusion

In the most recent Nicor Gas rate case, ICC Docket No. 04-0779 (Order Sept. 20, 2005), the Commission approved the use of a ten-year average of heating degree day statistics for the Nicor Gas service territory directly adjacent to the territories of North Shore and Peoples Gas. In that case, the Commission held that a utility was free to suggest an appropriate averaging period, not necessarily thirty years, for the Commission to consider. ICC Docket No. 04-0779, Final Order at 57.

Staff does not oppose the Utilities' proposed weather normalization methodology or numbers.

One witness, GCI witness Mr. Glahn, was the sole witness to attempt to contest this issue. As a management consultant, Mr. Glahn has experience with statistics, but he is not and does not hold himself out as a climate scientist. Mr. Glahn argued that the long term average calculated once per decade by the National Oceanic and Atmospheric Administration ("NOAA"), using thirty years of data, would be appropriate here. GCI Ex. 3.0, 40:1-4. The most recently available average is based on the years 1971-2000. PGL Ex. EST-1.0, 28:623-626; NS Ex. EST-1.0, 28:622-625. Despite his background in statistics, Mr. Glahn did not offer any statistical reasons why his metric would have better predictive power. Rather, he opined that using "more data" would necessarily be superior and would avoid effects of shorter term fluctuations. GCI Ex. 6.0, 20:499-500.

The Utilities' approach is demonstrably superior, both statistically and scientifically. As to the statistics presented, the Commission finds persuasive the fact that, based on all the years of data at the relevant weather station, a ten-year average has significantly less error than a thirty-year average at predicting weather in the first through fifth years. The Commission agrees with the Utilities that volumetric rates should be set based on an accurate projection of normal weather during the years when the rates are likely to be in effect. The Commission also believes that consistency of methodology with neighboring gas utility Nicor Gas, while not essential, is appropriate and desirable.

The Commission also notes that no party other than the Utilities presented testimony of a climate scientist, and no party contested Professor Takle's conclusions about the warming trend in the climate of northern Illinois.

Accordingly, based on the evidence, the Commission finds that the proper average is the ten-year average, and that 6,044 HDD should therefore be used for purposes of calculating the Utilities' billing determinants.

VII. NEW RIDERS

The Utilities in these proceedings have identified uncollectible expenses, energy efficiency program costs, and infrastructure replacement costs as the type of costs that should be recovered through automatic rate adjustments. In addition, the Utilities have proposed a "decoupling" mechanism (Rider VBA) to address incentives in the current rate structure for the Utilities to increase gas sales and not to support conservation. Hence, the Utilities have proposed four (4) new rate riders which would provide the rate flexibility necessary to address the realities in

today's business environment. These mechanisms, Rider VBA (or, as an alternative, Rider WNA), Rider UBA, Rider EEP and Rider ICR (applicable only to Peoples Gas), will each in turn be discussed below.

A. Overview

North Shore / Peoples Gas

North Shore and Peoples Gas have proposed five different new “tracker” riders: Riders VBA, WNA (as an alternative to VBA), ICR (Peoples Gas only), EEP, and UBA. Each rider presents an automatic adjustment mechanism for some factor affecting the revenues or expenses the Utilities experience. The Utilities assert that each of the riders meet the traditional tests to be valid and useful riders. As far back as *City of Chicago v. Illinois Commerce Comm’n*, 13 Ill. 2d 607, 608-609 (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.

Other parties

[Insert]

North Shore / Peoples Gas Response

The utilities point to two of the more recent judicial decision pertaining to riders, enunciate the Illinois parameters with a good measure of clarity and address those traditional constraints pertaining to retroactive and single issue ratemaking, as well as test year adherence. These cases are *A. Finkl & Sons Co. v. Illinois Commerce Commission*, 250 Ill.App.3d 317 (1st Dist. 1993) (“*Finkl*”), and, *Citizens Utility Board v. Illinois Commerce Commission*, 166 Ill.2d 111 (1995) (“*CUB I*”). In *Finkl*, the court held that “riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses. *Finkl*, 250 Ill.App.3d at 327 (emphasis in original). The focus is on whether the costs in question can be controlled by the utility or whether those costs can be predicted with certainty. In a subsequent case, *City of Chicago v. Illinois Commerce Comm’n*, 281 Ill.App.3d 617 (1st Dist. 1996), 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.

Riders have been generally determined not to be single issue ratemaking. As the Illinois Supreme Court observed:

[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 137-138. Therefore, the Utilities assert, each of their proposed riders meet the basic tests to be considered valid riders.

Commission Analysis and Conclusion

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. The terms used have included: unexpected, unforeseeable, volatile, uncertain and fluctuating. The common theme and implied analytical framework is quite apparent. 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 proposed riders meet this description.

The arguments that the riders constitute retroactive ratemaking are similarly unavailing. In upholding riders, the Illinois courts have also necessarily and in fact held that riders do not violate test year rules or proscriptions against single issue and retroactive ratemaking and the Commission does not believe the riders proposed by the Utilities raise cognizable issues pertaining to test year, retroactive ratemaking and single issue ratemaking matters.

The arguments opposing the implementation of new riders on the grounds that they would impose administrative burdens on the Staff and others are rejected. The Commission does not believe that the proposed riders present any particularly complicated or burdensome challenges. They appear to be rate mechanisms of the kind that are routinely administered by the Commission and the arguments concerning their complexity and difficulty in managing them are rejected.

The Commission therefore finds that implementation of the riders is well within the authority of the Commission and that the riders themselves do not present any challenges to the Commission or the Staff that are not normally a part of the administration of the PUA.

B. Rider VBA and Rider WNA

1. Rider VBA

North Shore / Peoples Gas

A very large percentage of the Utilities costs are fixed. Even with the Utilities' proposed rate designs, however, a significant portion of fixed costs will be recovered through volumetric distribution charges. Rider VBA is a rate mechanism designed to provide the Utilities with a measure of assurance of recovery of the portion of the revenue requirement approved by the Commission in these proceedings that is to be recovered through those volumetric charges. Rider VBA is commonly known as a decoupling mechanism. The purpose of decoupling is to remove both the incentive utilities have to increase sales and the disincentive utilities have to encourage energy efficiency for their customers. The Utilities have proposed Rider VBA based on their recognition of current environmental and economic realities and the impact of those factors on the regulatory process and the utility business.

Specifically, Rider VBA is a mechanism which will determine an adjustment on a monthly basis for the effects of weather and usage changes, such as those caused by conservation, on the Utilities' rates. Rider VBA will be applicable to the Utilities' customers under Service Classification ("S.C.") Nos. 1N, 1H and 2. A separate adjustment would be determined for each applicable service classification. The Rider VBA adjustment would be computed on a monthly basis by taking the difference between a baseline rate case distribution margin per customer (Rate Case Margin) factor against actual distribution margin (Actual Margin) in a given month. The Rate Case Margin for each month would be based on the Commission approved distribution margin for each month divided by the number of Commission approved customers (Rate Case Customers) for the same month. The difference will be multiplied by the Rate Case Customers and divided by the number of therms estimated for the effective month of the adjustment, yielding the monthly per therm adjustment. The actual adjustment will be computed and applied to customers' bills each month using actual and rate case data from the second month prior to the effective month of the adjustment to be charged. Grace Dir., PGL Ex. VG-1.0 2REV, 47:1038-1052; NS Ex. VG-1.0 3REV, 42:928 - 43:942.

A Base Customer Margin per customer and average number of customers level for each applicable rate classification will be established and a separate adjustment will be computed for each service classification. The monthly adjustments will be established by calculating the difference between the Base Customer Margin and the Actual Margin per customer for the applicable month. That difference will be multiplied by the Rate Case Customers and divided by the number of therms estimated for the effective month of the adjustment, yielding a monthly therm adjustment. *Id.* at 47:1046-1052 and 43:936-942, respectively.

Rider VBA would be subject to an annual reconciliation with adjustments to insure that the implementation of Rider VBA is in compliance with tariff provisions and would be filed on the 20th of the month to permit Staff review prior to the effective date of the adjustment. Annual internal audits would be conducted by the Companies. Grace Dir., PGL Ex. VG-1.0 2REV, 48:1059-1062; Grace Dir., NS Ex. VG-1.0 3REV, 43:949-952; Hathhorn Dir., Staff Ex. 1.0, 28:581-587.

Other Parties

[Insert]

North Shore / Peoples Gas' Response

While certain parties have introduced generalized arguments that the Utilities' actions have no bearing on customer conservation decisions, the existence of the "Throughput Incentive" cannot be denied. The Throughput Incentive encourages a utility such as Peoples Gas or North Shore to be financially motivated to increase sales of natural gas (relative to historical levels which underlie base rates) and to maximize the "throughput" of natural gas across its utility system. Under the traditional utility ratemaking structure, a utility is financially motivated to increase its sales levels in a future period above that established in its previous rate case because its rates are designed to recover most fixed costs on a volumetric basis – causing the utility's revenues to increase as its sales increase. Under traditional utility ratemaking, an increase in the recovery of fixed costs will occur (compared to the level approved in the utility's most recently completed rate case) when sales are higher than assumed in the design of the utility's rates.

Conversely, a decrease in the recovery of fixed costs will occur when sales are low relative to assumed levels. This situation creates an automatic disincentive for utilities to promote conservation or energy efficiency initiatives because such actions will reduce the utility's revenues and resulting earnings. The Utilities would compute a monthly adjustment under proposed Rider VBA to offset the revenue impact of increases or decreases in sales. By doing so, proposed Rider VBA would effectively eliminate the link between sales and earnings. Hence, Rider VBA would encourage the Utilities to be supportive of measures which would promote decreased energy usage, conservation, or other energy efficiency initiatives. Feingold Dir., PGL Ex. RAF-1.0. The only other arguments which have been put forth in opposition to Rider VBA are that it departs from "traditional ratemaking" and would introduce a measure of complexity and administrative burden for regulators. Such arguments are meritless and have been put forth solely in an effort to maintain the *status quo*. It cannot be disputed that more and more state commissions are approving revenue decoupling mechanisms similar to Rider VBA in recognition that such mechanisms have identifiable benefits for ratepayers and utilities. The state of New York has even seen fit to recommend that all utilities in the state propose decoupling measures to address today's business realities. *Re Investigation of Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, et al.*, 256 P.U.R. 4th 477, 2007 WL 1185703 (N.Y.P.S.C. Apr. 20th, 2007) (Docket No. 03-E-0604).

Rider VBA is an opportunity for the Commission to participate in this growing acknowledgement of the need for rate setting bodies to address issues of global warming impacts and energy independence and their impact on energy utilization, conservation and utility financial stability. Rider VBA serves these critical goals by providing the Utilities with a measure of financial stability that will enable them to participate enthusiastically in promoting energy conservation and efficiency without the fear of undermining their business interests.

Decoupling mechanisms and their rate tracking features have been widely adopted by state regulatory commissions over the past several years. Decoupling mechanisms had been adopted in at least 9 states when the Companies filed their cases and that number had risen to 11 nearly six months later with 14 additional states considering decoupling in some manner. Feingold Sur., NS-PGL Ex. RAF-3.0, 5:97-99. Feingold Sur., NS-PGL Ex. RAF-3.0, 5:96-99. Decoupling mechanisms are becoming increasingly more common across the country in response to significant environmental and national interest considerations, as well as the business challenges faced by natural gas utilities. The environmental challenges that Rider VBA would address are issues of global climate change and the need for the nation to become more self sufficient in energy. NS-PGL Init. Br. at 110-111. Exhibit NS-PGL RAF-2.3 below shows the increasingly widespread adoption of decoupling mechanisms across the U.S. While no decoupling mechanisms have been adopted in the state of Illinois, the policy challenges and business justification which are the predicate for decoupling mechanisms certainly exist.

Among these new realities is that utilities can no longer expect that increased sales are a viable business goal in the face of declining use and the rising cost of natural gas. Moreover, current concerns over global warming and dependence on energy imports have prompted utilities and other policy makers to reevaluate existing regulatory models and express support for decoupling. As detailed below, this has resulted in an ever increasing number of utility proposals and regulatory decisions to implement decoupling and similar type rate policies.

The Utilities point to numerous decisions of other state commissions approving decoupling, and urge the Commission here to make a similar decision. While certainly some decoupling mechanisms have not been approved, the trend is clearly toward broader approval. Further the Utilities' financial under-performance over the recent past is clearly indicative of acute business challenges that give rise to the need for new ratemaking approaches because traditional ratemaking approaches do not address current business and environmental realities. A utility's financial results and the environmental consequences of certain ratemaking practices cannot be ignored or downplayed simply to preserve the *status quo*.

Furthermore, Rider VBA will not entail any shift of risk to customers because it does not guarantee any specific financial performance. To the extent normal weather is assumed over time, Rider VBA's adjustment to reflect weather represents no risk shifting. Similarly, risks attendant to throughput are evened out by the upward and downward adjustments for warmer and colder weather, respectively. There is no adjustment if the Companies add or lose customers relative to the customer levels established in these proceedings. The adjustment for usage is symmetrical, i.e., declines and increases are taken into account. Feingold Reb., NS-PGL Ex. RF-2.0, 50:1017-51:1032.

Commission Analysis and Conclusion

The Commission has historically been responsive to changing business realities and has not hesitated to apply various rate methods to achieve its policy objectives, including the implementation of trackers. Indeed, the Commission has consistently employed rate tracking mechanisms in the form of riders, whether statutorily authorized, *e.g.*, 220 ILCS 5/9-220, or implemented by the Commission on its own initiative. *See Re Investigation Concerning Issues Related to Coal Tar Cleanup Expenditures*, 137 P.U.R. 4th 272, 1992 WL 333219 (Ill. C.C. Sept. 30, 1992) (Docket No. 91-0080 *et al.*).

The Commission has made it abundantly clear that rate tracking is an acceptable means of utility cost recovery and the Courts have upheld this view. *City of Chicago v. ICC*, 13 Ill.2d 607 (1958). In *City of Chicago*, the Court held: "We conclude that the Public Utilities Act of Illinois vested in the commission the power to authorize an automatic adjustment clause to be filed in a rate schedule in the proper case." *Id.* at 614. Given the Commission's consistent application of trackers when justified, it cannot reasonably be argued that such mechanisms are inappropriate or unreasonable.

This Commission has consistently acknowledged the usefulness of rider mechanisms when costs vary widely and there are difficulties in making forecasts of the scope, costs and timing of eligible costs. *See, e.g., Central Illinois Light Company*, 124 P.U.R. 4th 498, 1991 WL 501759 (Ill. C.C. Aug. 2, 1991) (Docket No. 90-0127). Thus, the Utilities' proposals to implement rider mechanisms to recover various costs in these proceedings that are unpredictable or outside the control of the Utilities are reasonable and well within the parameters of the Commission's lawful authority and policy. Arguments that rate riders are "piecemeal", "nontraditional" or otherwise are problematic, as urged by witnesses Messrs. Lazare and Brosch, Staff Ex. 8.0, 9:201-205; GCI Ex. 1.0, 11:15-21, are simply unavailing in the face of the long standing and judicially sanctioned use of rate trackers in Illinois, and discussed earlier in this Order.

The record demonstrates that Rider VBA would effectively address environmental and national interest objectives which should be key considerations in current rate regulatory decisions. Rider VBA does so by enhancing the promotion of energy conservation and efficiency measures by the Utilities through the decoupling feature. The decoupling occurs by removing the effects of weather and customer usage from the determination of how much of the utility's revenue requirement is recovered. The throughput on the system in a given period is decoupled, or separated, from the amount of the recovery. The Utilities, then, have no incentive to sell any particular level of gas volumes because the revenue requirement is met with less emphasis on the amount of gas sold or transported.

The Throughput Incentive, and its conflict with the goal of energy efficiency promotion, has been established as a sound basis for implementing revenue decoupling. *Re Northwest Natural Gas Co.*, 245 P.U.R. 4th 165, 2005 WL 2222265 (Or. P.U.C. Aug. 25, 2005) (Docket No. 05-934). The Commission finds that Rider VBA is a reasonable means of addressing important rate design objectives. Rider VBA would allow the Utilities to recover the distribution revenues approved in this proceeding based on the number of customers underlying the rates established in this proceeding. Moreover, the Commission finds that Rider VBA appropriately determines monthly adjustments and includes appropriate reconciliation and auditing provisions to assure that customers will not over or under pay the distribution revenues approved in this proceeding. Rider VBA does not shift risks to customers and does not act in a way which would be a disincentive to energy conservation. As the Utilities' have not proposed nor do not recover all of their fixed costs through fixed charges, Rider VBA would also allow the Utilities' to adequately recover such fixed costs.

The Commission finds the arguments that Rider VBA contravenes the proscription against single issue and retroactive ratemaking, as well as test year rules unpersuasive. Rider VBA represents a reasoned and balanced approach to the challenges facing the Utilities. Rider VBA is intended to recover revenues that are approved by the Commission in this Order and will not involve allowing the Utilities to recover more or less than that allowance in the future. The Commission finds that the recovery of the margin revenues through Rider VBA are appropriate.

2. Rider WNA

North Shore / Peoples Gas

While the Utilities have thoroughly established in the record the need for Rider VBA, an alternative mechanism, a weather normalization adjustment (Rider WNA), could achieve certain of their goals and the goals of decoupling. While Rider VBA is the Utilities' preferred methodology since it addresses the inappropriate incentives under the current regulatory regime, the Utilities have offered, in the alternative, a Rider WNA mechanism to address solely the impact of weather. *Borgard Reb.*, NS-PGL Ex. LTB-2.0, 12:272-280.

Proposed Rider WNA is conceptually equivalent to the weather normalization adjustment mechanisms noted by Mr. Feingold when he discussed the gas distribution industry's ratemaking responses to the under recovery of fixed costs. *Feingold Dir.*, PGL Ex. RAF-1.0, 21:422-425; *Feingold Dir.*, NS Ex. RAF 1.0, 19:422-425.

The Companies' gas rates are designed on the basis of the expected volume of gas to be sold for these services under normal weather conditions. This means that the Companies will recover their annual fixed costs of providing delivery service only if the level of sales volumes upon which their rate designs are predicated is achieved. That sales level is based upon the Companies' weather-normalized gas volumes. Rider WNA will ensure that the level of sales volumes established to recover their fixed costs is always reflected in the monthly billings to their customers.

Rider WNA can send more accurate price signals to the Companies' customers compared to the current ratemaking method because it will stabilize the portion of a customer's bill related to the recovery of fixed costs, while still recovering the variable gas costs on a volumetric basis. Feingold Reb., NS-PGL Ex. RAF-2.0, 60:1226-1251. The Utilities' proposed Rider WNA would consist of a monthly adjustment to gas bills. Rider WNA would establish service class specific weather adjustments for each of S.C. Nos. 1N, 1H and 2 (heating customers only). These adjustments would be determined by using service class specific Heat and Base Load Factors and Normal and Actual Heating Degree Days to determine weather adjustment volumes.

The weather adjustment volumes would be multiplied by the service class specific Base Rates to determine the WNA. The adjustments would be determined for the months of October through May only with an annual report to be submitted to the Commission by September 30 of each year. The Heat and Base Load Factors, Normal Heating Degree Days and Base Rates would be established in these proceedings. The Companies' Base Rates would be the end block rates approved by the Commission for S.C. Nos. 1H and 2. Grace, Reb., NS-PGL Ex. VG 2.0, 55:1219-57:1247. The Companies' Base Rate for S.C. No. 1N would depend upon the rate structure approved by the Commission in this proceeding and would be either a flat rate or an end block rate. Grace, Reb., NSPGL Ex. VG 2.0, 55:1219-57:1247; Grace, Sur. NS-PGL Ex. VG 3.0, 28:592-29:611.

Other Parties

[Insert]

North Shore / Peoples Gas' Response

No party has contended that a WNA is not a valid and widely accepted means of addressing weather in rates. Indeed, one of the principal opponents of Rider VBA, Mr. Brosch, admits that WNA's have been widely adopted and are a reasonable means of addressing weather in rates. *See* Brosch, Tr. at 1522:4-16; Brosch Dir., GCI Ex. 1.0, 41:13-15. The Utilities have also shown that the tangible benefits from implementing Rider WNA are: (1) it will reduce bill variability due to weather in the bill for the month in which the variation occurs; (2) the adjustment is consistent with the rate class approach that is used to normalize sales volumes to derive the Utilities' delivery service charges; and (3) the individual customers retain the savings due to their own energy conservation practices. Feingold Reb., NS-PGL Ex. RAF 2.0, 65:1329 – 66:1335. Since it does not require a deferral mechanism, Rider WNA could also smooth out monthly and seasonal cash flows. Feingold Reb., NS-PGL Ex. RAF-2.0, 65:1331 - 66:1341.

Rider WNA can send more accurate price signals to the Companies' customers compared to the current ratemaking method because it will stabilize the portion of a customer's bill related

to the recovery of fixed costs, while still recovering the variable gas costs on a volumetric basis. Feingold Reb., NS-PGL Ex. RAF-2.0, 60:1226-1251. The Utilities' proposed Rider WNA would consist of a monthly adjustment to gas bills. Rider WNA would establish service class specific weather adjustments for each of S.C. Nos. 1N, 1H and 2 (heating customers only). These adjustments would be determined by using service class specific Heat and Base Load Factors and Normal and Actual Heating Degree Days to determine weather adjustment volumes.

Deviations from normal weather can result in either over or under recovery of the Companies' annual margin revenues when actual weather experienced is colder or warmer than normal, respectively. Such over or under recoveries will produce erratic financial results that would cause the financial community not to look as favorably at a utility's financial position relative to the financial positions of other utilities with weather normalization clauses, all other things being equal.

Rider WNA will directly address the ever-increasing issue of volatility in customers' gas bills – this ratemaking mechanism will provide more stable annual bill amounts and mitigate volatility in customers' monthly gas bills. Customers will be better able to budget for and pay their monthly bills.

The consumer is inclined to look with disfavor on the utility whenever the bill increases greatly during periods of high gas consumption and to overlook those occasions when the bill is lower. As described above, Rider WNA will directly address this issue by providing more stable annual bill amounts and mitigation of volatility in monthly gas bills.

WNA's have been adopted in at least 25 states representing 44 utility service areas, and the trend is toward greater utilization of those mechanisms. Over 80% of those utilities that have adopted Rider WNA are using a real-time approach, which is identical to the approach proposed by the Utilities. *See id.*, 66:1345-1352; NS-PGL Ex. RAF-2.7. Mr. Feingold has noted that another means of addressing the business challenges associated with fixed cost recovery is by adoption of a straight fixed variable ("SFV") design which he indicates has been adopted in four states. Feingold Reb., NS-PGL Ex. RAF-2.0, 14:67 - 15:288. Thus, combining the states which have adopted SFV rate design with those which have adopted decoupling mechanisms or WNA mechanisms presents a very compelling picture, indeed. As illustrated below, as of July 2007, revenue decoupling, SFV or WNA proposals are pending in 38 states. Such "non-traditional" rate mechanisms have actually been adopted in 36 states. NS-PGL Exs. RAF-2.3, RAF-2.7.

This Commission would not, therefore, be breaking new ground by approving a Rider VBA or Rider WNA in these proceedings. In fact, Illinois would be simply catching up with the trend among the states and recognizing that conservation and national energy independence imperatives, as well as today's business environment have created unique circumstances that require different policy making decisions than have been required in the past. Peoples Gas and North Shore have proposed specific ratemaking models to address indisputable business and policy challenges. Those methods, Rider VBA and Rider WNA, are reasonable and measured approaches to meeting the demonstrated challenges. While parties have been critical of the Utilities' proposals in general and identified arguable implementation issues, no party has remotely demonstrated that Rider VBA and Rider WNA are unreasonable *per se*. Moreover, no

other party has offered a comprehensive or other viable approach to resolving the challenges presented.

Commission Analysis and Conclusion

The Commission has found that Rider VBA is reasonable and appropriate and has approved proposed Rider VBA. Accordingly, it need not address the arguments about Rider WNA, which was offered only as an alternative to Rider VBA.

Alternative language if Rider VBA is not approved

Rider WNA, offered by the Utilities as an alternative to its preferred decoupling mechanism, Rider VBA, is conceptually and otherwise very similar to Rider VBA. The Commission believes that Rider WNA will appropriately address the effects that variations from normal weather will have on the revenues arising from rates established in this proceeding. As such, Rider WNA does not contravene any Commission rules or other proscriptions. Although decoupling type mechanisms such as the Utilities' proposed Rider VBA has some merit and is gaining acceptance in other jurisdictions, this Commission believes that a decoupling mechanism such as Rider VBA is too great a step to take at this time.

The Commission nevertheless believes that the Utilities have made a compelling presentation that current climate and business challenges warrant addressing through ratemaking. The Commission finds that Rider WNA would be an appropriate middle ground to meet the climate and business challenges discussed in this Order. The Commission therefore finds that Rider WNA is the most reasonable means of managing the identified challenges pending further policy consideration of broader solutions, such as decoupling.

C. Rider ICR

Peoples Gas

Currently, Peoples Gas' system includes nearly 2,000 miles of cast iron and ductile iron ("CI/DI") mains. This amount represents a considerable portion, approximately half, of the Peoples Gas system mains. Peoples Gas has been steadily replacing this main for many years. The Company is proposing to accelerate the pace at which CI/DI main is replaced, provided that it is allowed to timely recover the costs of this accelerated capital investment. Peoples Gas' proposed Rider ICR is a mechanism to recover the recurring capital-related costs of its proposed acceleration of CI/DI main replacement on its system. Rider ICR enables Peoples Gas to take advantage of more opportunities as they arise to replace vintage portions of its gas system without the negative financial consequences such business actions would create under traditional ratemaking methods. Feingold Dir., PGL Ex. RAF-1.0, 44:876-882.

Other Parties

[Insert]

Peoples Gas' Response

Rider ICR, as originally proposed, was a mechanism which established a base of expenditures above which Peoples Gas could have the ability to expend and recover CI/DI related replacement facilities. Subsequently, the Company agreed to numerous modifications of Rider ICR, most of which were proposed by the Commission Staff. The Company did not agree to a proposal by Ms. Hathhorn to include a return credit provision in Rider ICR. Staff also recommended the renaming of the rider to Rider QIP. Staff Init. Br. at 196. To the extent, however, that elements of the old Rider ICR are necessarily a part of Rider QIP, they are not being abandoned.

The Company has agreed to adopt the following modifications recommended by Ms. Hathhorn: (1) a criterion that only the costs of CI/DI main replacement program are recovered in the Rider mechanism through the provision of specific eligibility criteria; (2) creation of a separate revenue sub-account; (3) a cap of 5% of base rate revenues; and (4) an annual reconciliation of prudently-incurred costs. Schott Reb., NS-PGL Ex. JFS-2.0, 4:64-68.

Both Staff witness Lazare and GCI witness Brosch have contended that Rider ICR does not meet the purported tests for rate tracking riders. Peoples Gas does not agree that there are rigid prescriptions for employing riders. As Mr. Feingold points out, rate trackers have increasingly become a reasonable and useful mechanism employed by utilities and approved by regulators to recover the costs of extraordinary expenses. Feingold Reb., NS-PGL Ex. RAF-2.0, 32:648-652. Indeed, Mr. Feingold has described several examples of infrastructure riders in existence. Feingold Reb., NS-PGL Ex. RAF-2.0, 33:657-34:680. Furthermore, the Commission has implemented riders in numerous instances and the general rule is that riders may be employed in those cases where the costs at issue warrant rider treatment. Rider treatment is warranted where the costs are unforeseeable and difficult to project or where the costs are not within the control of the utility. *Finkl*, 250 Ill. App. 3d 317 at 327. The Company has established that there are several important benefits that accompany accelerating CI/DI main replacement. Among these are considerably shortening the approximate 40 year time frame for completing the main replacement. The Company has established that the most significant opportunities to replace obsolete mains present themselves when the City of Chicago or third parties pursue development projects which permit the Company to coordinate its main replacements simultaneously.

Certain parties have argued that the Company has managed to replace CI/DI main at a safe and reasonable pace since the main replacement program began in 1981 and that therefore, an accelerated approach may not be necessary. What the argument fails to acknowledge, however, is that Rider ICR is being proposed to further accelerate CI/DI main replacement to reduce the costs of the main replacements, while allowing Peoples Gas the ability to respond to unknown, unforeseen and unpredictable opportunities that bring about additional potential benefits for ratepayers. Pointing out that Peoples Gas has replaced main safely and efficiently since 1981 does not diminish the propriety of enhancing that activity and achieving greater savings than might otherwise result. Schott Reb., NS-PGL Ex. JFS-2.0, 12:242 - 13:251 and 8:160 - 9:176.

Peoples Gas states that ratepayers will not pay a premium for the acceleration through Rider ICR, as urged by Mr. Lazare. *See* Lazare Dir., Staff Ex. 8.0, 36:754-756. Rather, there are unique opportunities for the ratepayers to capture savings through the projects that might permit greater replacement opportunities than would otherwise occur. Aside from time value of money considerations, Rider ICR will not result in additional costs to ratepayers over what would be paid in any event for CI/DI main replacement in the aggregate and Peoples Gas will not obtain any financial benefit that is different from the rate case treatment which it is normally accorded for capital expenditures. Schott Reb., NS-PGL Ex. JFS-2.0, 9:172-181.

Staff, through its witnesses Mr. Lazare and Ms. Hathhorn, and GCI, through its witness Mr. Brosch, argue against some or all aspects of the mechanics of Rider ICR. No one, however, has challenged the acceleration concept, *per se*.

Peoples Gas states that the benefits of acceleration include: (1) financial benefits associated with expending current dollars for a major monetary undertaking; (2) benefits relating to the replacement of Peoples Gas' low pressure system; and (3) benefits afforded by the opportunity to respond to the dynamic development in the City of Chicago. Schott Dir., PGL Ex. JFS-1.0, 6:121-125.

The City of Chicago supports Peoples Gas' request for approval of its proposed accelerated main replacement program and Rider ICR, which it contends will allow the utility to pursue the accelerated program without the financial risk of delay in recovering the costs of the program in its next rate case.

Peoples Gas strongly opposes Staff's proposal to include in Rider ICR a rate of return credit that is fashioned after one that is in Part 656 of the Commission's Regulations. While Peoples Gas was amenable to revising its Rider ICR to comport with much of Staff's recommended changes based on Part 656, Peoples Gas does not believe that every single element of Part 656 should be applied to its program. Schott Sur., NSPGL Ex. JFS-3.0 2Rev., 3:45-51. Rider ICR was intended to be a straightforward mechanism to provide Peoples Gas with some rate recovery for the cost of acceleration of the replacement of CI/DI main between rate cases. Part 656 is a mechanism for the treatment of cost recovery by water and sewer utilities. Neither Ms. Hathhorn nor any other party has established why the return feature of Part 656 necessarily applies to natural gas systems or Peoples Gas in particular.

The credit mechanism is not inappropriate for Rider ICR because it could have the effect of eliminating recovery of the costs Rider ICR is designed to recover. Rider ICR is designed to recover costs that Peoples Gas actually expends for infrastructure replacement. If the Company does not incur costs, there is no ICR revenue. If the credit operates to limit or reduce the ICR revenue, the Company will be precluded from recovering the costs it would have actually expended for infrastructure replacement. Thus, even after Peoples Gas will have paid for infrastructure replacement and collected the allowed recovery from customers, the credit would, in effect, cause the Company to disgorge those collections, eliminating the recovery of costs intended by the operation of Rider ICR. Schott Sur., NSPGL Ex. JFS-3.0 2Rev., 5:92-101.

The benefits of modernizing the infrastructure and achieving significant savings on behalf of rate payers could be considerable and proposed Rider ICR will provide the Company

with a current basis to recover the recurring capital-related costs without the negative financial consequences to the Company. Infrastructure modernization is a challenge that is being addressed across the nation and in Illinois. Schott Sur., NS-PGL Ex. JFS 3.0 2REV, 7:148-150. These challenges are particularly acute as they pertain to vintage facilities in old urban areas like Chicago. Rider ICR presents the Commission with the opportunity to ensure that the natural gas pipeline infrastructure in the City of Chicago is the most suitable to meet long term service requirements.

Commission Analysis and Conclusion

As we have discussed above, the Commission has a long standing policy of implementing rate riders in appropriate circumstances. The circumstances surrounding the acceleration of CI/DI main replacement are an appropriate situation to implement a rider, not unlike other instances in which the Commission has employed riders. The difficulty in forecasting and uncertain timing of the level and incurrence of expenditures are the precise features that the Commission has determined justify rider treatment in other cases, such as in *CILCO*. Moreover, the very large expenditures that are expected to be involved in infrastructure replacement cost recovery and the very high degree of unforseeability of project expenditures over time render the costs particularly suitable for rider treatment.

City of Chicago v. Illinois Commerce Comm'n gives the Commission broad latitude to employ ratemaking mechanisms, including riders, in those circumstances that warrant it. The Commission believes that the replacement of CI/DI main in the City of Chicago presents a unique circumstance that justifies employment of a rider to facilitate the acceleration of replacing these facilities. We believe that Chicago is unique in the State of Illinois and that the extent and density of the natural gas infrastructure system in Chicago presents a compelling case that the City is uniquely situated. Mr. Schott's map of the City presented in Schott Sur., PGL Ex. JFS-3.2, clearly supports this conclusion. See *Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill.2d 111, 137-138, 651 N.E.2d 1089 (1995) (the Commission may approve the recovery of unique costs through a rider where warranted).

Furthermore, the Commission is convinced that the Company will not have the ability to predict the nature or extent of accelerating CI/DI replacement costs since the precise timing of such costs is dependent upon events that may arise unexpectedly or are not presently known. The expenditures for main replacement are even more uncertain when it is considered that replacement may be dependent upon decisions of the City of Chicago or third parties. In view of the dynamic nature of the City of Chicago and the large scale projects that have been announced, Schott Dir., PGL Ex. JFS-1.0, 11:238-253; 12:281-287, when and how much might be expended for infrastructure replacement could be very difficult to predict and the ability to control the particulars of the expenditures could be beyond the control of Peoples Gas.

The Commission therefore finds that the uncertainty that attends attempting to foresee Peoples Gas' accelerated infrastructure replacement costs and the extent to which the incurrence of those costs may be beyond the control of the utility warrants giving the costs rider treatment. The costs are clearly within the prescriptions set forth in *Finkl* and *CUB I*.

The arguments of the Staff and others that rider treatment would constitute single issue ratemaking are also misplaced. *CUB I*, 165 Ill.2d at 137.140.

Although the argument has been made that Rider QIP will cause a shift of risk from the Company to the ratepayers, this argument is unpersuasive and unsupported by the record. It has not been demonstrated that Rider QIP would put ratepayers in a different position than might otherwise occur since Rider QIP costs will be incurred whether on an accelerated basis or under the existing program. It should also be noted that the arguments that Rider QIP will undermine Peoples Gas' incentive to control costs are unpersuasive.² The 5% cap on expenditures and the reconciliation process with an opportunity to review prudence should sufficiently address this concern.

Although the parties have urged that Ms. Hathhorn's revenue credit proposal be adopted, no party except for Ms. Hathhorn has submitted any evidence that establishes why the credit is needed. Peoples Gas has submitted ample evidence that the revenue credit would undermine the purpose of Rider QIP.

The Commission finds that Rider QIP as modified by the proposals that have been accepted by Peoples Gas is a just and reasonable approach to implementing Peoples Gas' acceleration replacing CI/DI main on its system.

D. Rider EEP (Merits of Energy Efficiency Programs and Rate Treatment)

1. Merits of Energy Efficiency Programs

North Shore / Peoples Gas

The Utilities proposed a new ratepayer funded energy efficiency program of not less than \$7.5 million per year (\$6.4 million for Peoples Gas and \$1.1 million for North Shore), Rider EEP. This satisfied a merger condition the Commission approved in *In re WPS Resources Corp.*, ICC Docket No. 06-0540. The proposed program's Governance Board would consist of five voting members (ELPC, the Utilities, the City of Chicago, a consumer advocacy group and a North Shore service territory government or consumer member) and one non-voting member (a member of Staff) (PGL Ex. IR-1.0, 6:130-7:141), which would help to ensure its independence from the Utilities. *See* NS-PGL Ex. IR-3.0, 5:90-97. The Utilities anticipate that much of the program will offer rebates and other incentives supporting energy efficient technologies and other gas-saving techniques. *See* PGL Ex. IR-1.0, 11:237-15:327.

² Staff took this position in respect of the original Rider ICR proposal which involved a base and incremental approach. The Rider QIP proposal does no such thing and Staff does not mention this argument in its discussion of Rider QIP. *See* Staff Init. Br. at 195.

The AG

[Insert]

City-CUB

[Insert]

Staff

[Insert]

North Shore / Peoples Gas Response

The Utilities opposed Staff's claim that the program is unfair because it may not garner 100% customer participation by pointing out that there are any number of tax-supported programs and services that are undertaken despite the fact that they will not be utilized by 100% of the taxpayers who pay for them, such as schools, firefighting services, and construction of roads. The Utilities further noted that concerns about participation levels merely suggest, if anything, that outreach efforts and other efforts to publicize the program should be vigorous, and they will be. *See* PGL Ex. IR-3.0, 17:370-83.

The Utilities considered Staff's claim that the program is inefficient because high utility prices should be sufficient to incentive consumers to adopt energy efficient technologies and gas saving techniques (Staff Init. Br. at 204) as equally unpersuasive. They noted that some customers will make better choices with extra incentives, NS-PGL Ex. IR-3.0, 2:38-44, and agreed to support inclusion of a requirement that the program will only invest in cost-effective measures. *See* PGL Ex. IR-3.0, 4:75-80.

The Utilities disagreed with Staff's claim that the program will be inefficiently governed but agreed to abide by whatever structure the Commission orders.

Commission Analysis and Conclusion

In *In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779, the Commission stated that:

The Commission understands the importance of energy efficiency, and has begun to address other aspects of the issue in the Sustainable Energy Plan. That being said the Commission understands the importance and critical necessity of using energy efficiency plans as strategic tools to protect Illinois consumers and reduce their energy costs. Indeed, this Commission has begun to address other aspects of this issue in the Illinois Sustainable Energy Plan. We believe that smart energy efficiency programs will have two effects. First, they will lower the cost of heating for the home or business participating in the program. Second, targeted correctly, they will reduce the amount of high cost natural gas that Illinois has to buy, thus reducing everyone's costs, as well.

(Final Order Sept. 20, 2005, at 192). In that docket, however, the Commission declined to force an energy efficiency program on a utility that had not proposed it and did not support it. Since that time, no utility has proposed or put into effect a meaningful conservation program. The Commission applauds Peoples Gas and North Shore as well as the Environmental Law and Policy Center and the governmental and consumer intervenors for working cooperatively to craft the first such program in Illinois.

As a condition to the merger approved in *In re WPS Resources, Inc.*, ICC Docket No. 06-0540, the Commission required the Utilities to propose a new ratepayer funded energy efficiency program of not less than \$7.5 million per year. The Utilities fulfilled that condition by proposing Rider EEP. The Utilities' proposed governance structure for the program should ensure independence from the Utilities and will likely result in representation of all or substantially all relevant interests. The program's anticipated focus on rebates and other incentives supporting energy efficient technologies and gas saving techniques is appropriate and may encourage greater utilization of such technologies and techniques than high prices alone.

Staff has long resisted all such ratepayer-funded conservation plans. The Commission rejects Staff's arguments that the program is necessarily inequitable and inefficient. With proper independent governance and oversight, and with the selection of appropriate, cost-effective efficiency measures, the Commission believes that the proposed programs will make a significant positive contribution to the benefit of all ratepayers. Accordingly, the Commission orders the Utilities to implement the program as proposed.

2. Rate/Rider Treatment

North Shore / Peoples Gas

The Utilities' proposed Rider EEP will recover the Utilities' expenses of providing funding for the costs of energy conservation and efficiency programs for their customers through qualified independent third party administrator(s). Feingold Dir., PGL Ex. RAF-1.0, 42:835-837. The purpose of Rider EEP is to compute, on an annual basis, a monthly charge per customer for each applicable service classification (S.C. Nos. 1H and 2) to recover the incremental expenses that support the development and implementation of those energy efficiency programs. Grace Dir., PGL Ex. VG-1.0 REV, 40:879-881; NS Ex. VG-1.0 3REV, 35:769-771.

Other Parties **[Insert]**

North Shore / Peoples Gas' Response

Staff witness Ms. Hathhorn recommended certain language changes for Rider EEP and proposed that the Utilities establish an annual reconciliation procedure and internal audit process, as well as change the monthly tariff filing date. Hathhorn Dir, Staff Ex. 1.0, 29:601-605. The Utilities have agreed to the revisions suggested by witness Hathhorn. Grace Reb. NS-PGL Ex. VG-2.0, 51:1128.

Program cost recovery is considered to be an essential factor in order to achieve utility-sector energy efficiency programs and there should be a clear, reliable and timely regulatory process in place to ensure the recovery of these ongoing expenditures. A rate making mechanism that ensures predictable and timely recovery of energy efficiency and conservation program costs is particularly important for the Utilities because there are added uncertainties surrounding the precise timing of the rollout of their energy efficiency and conservation programs. This programmatic uncertainty makes it difficult to develop a specific amount to represent each year's costs of program implementation. As a result, it is appropriate and necessary for Peoples Gas and North Shore to have the ability to recover such costs through a ratemaking mechanism that can accommodate the anticipated variations in budgeted versus actual costs from year to year. Feingold Dir., PGL Ex. RAF-1.0 43:848-855, Feingold Dir., NS Ex. RAF-1.0, 40:861-869.

The Utilities point out that the *Finkl* decision, cited by the intervenors, 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 expenses in *Finkl* were not deemed to warrant rider treatment because the Court found that the rider costs involve payroll...; personnel training, education and travel; contractor 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 earlier in this Order, 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. The EEP costs are so largely 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. *See, CUB I.*

Utilities in various states such as Idaho, Massachusetts, Minnesota, Vermont, and Washington have received regulatory approval to recover the direct costs of their energy efficiency and conservation program through tariff provisions such as adjustment riders. Feingold Dir., PGL Ex. RAF-1.0, 43:860-44:863; NS Ex. RAF-1.0, 40:874-877. Clearly, there is an explicit recognition by the regulators in those states that assured recovery of energy efficiency costs is a necessary step in addressing the barriers many utilities face to investing in more energy efficiency measures.

While the Utilities would accept a deferred account procedure for handling EEP expenditure program recoveries so long as the deferred account process was annual, as opposed to between rate cases, the Utilities do not believe that the objections raised by witnesses Messrs. Brosch and Lazare flatly opposing the rider mechanism are valid. First, the fact that such costs have been previously recovered in a rider is a cogent and persuasive reason for employing a rider to recover EEP programs costs. Not only is the fact indicative of the Commission's employment

of riders in general, but it also is very indicative that the type of costs to be recovered are highly suited for rider treatment. Indeed, the difficulty in forecasting and uncertain timing of the level and incurrence of expenditures are the same features that the Commission has determined justify rider treatment in other cases, such as in the *CILCO* case discussed in Section VII(A) hereof. In addition, the size of the expenditures to be recovered under a rider should have no bearing on whether the rider should be employed if the costs otherwise are suitable for rider treatment.

If the energy efficiency program costs are not to be recovered through Rider EEP or deferral, then, in that situation, the evidence is uncontradicted that they must be added to the Utilities' revenue requirements for base rate recovery. *E.g.*, *Fiorella Reb.*, NS-PGL Ex. SF-2.0, 15:333 – 16:346.

Commission Analysis and Conclusion

The Utilities' proposed Rider EEP embodies the merger conditions approved by this Commission in *Re WPS Resources, Corp.*, 2007 WL 713200 (*Ill.C.C* Docket No. 06-0540, Feb 7 2007). NS-PGL Init. Br. at 130. One of the conditions contained in Docket. 06-0504 was that the Utilities would propose to implement energy efficiency programs which would be funded by ratepayers in an annual amount of \$7.5 million. *Id.* at Appendix A, Conditions 27-30.

Rider EEP costs meet the criteria for rider treatment. The parties objecting to rider treatment 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 know, 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. We disagree. 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.

The Commission therefore finds that Rider EEP is a reasonable means by which the Utilities may recover the EEP costs that they incur s a result of the programs established in the Reorganization Proceeding.

The Commission also finds that the Utilities' proposed structure for implementing Rider EEP, notably the independent Governing Board, and the terms and conditions of Rider EEP are reasonable and therefore approves it. The Commission additionally finds reasonable the \$6.4 million that is allocated to Peoples Gas and the \$1.1 million that is allocated to North Shore, as well as the portion of each amount that would be available for low income programs.

E. Rider UBA

North Shore / Peoples Gas

One of the major business challenges facing the Utilities is rising and uncontrollable bad debt expenses caused primarily by the level of wholesale natural gas prices. High customer bills result in more customers being slow or unable to pay, with higher delinquencies as the

consequence. More and higher delinquencies have led to greater net write-offs for the Utilities. Utilities that recover bad debt expense as a fixed cost component in base rates have experienced under-recovery of actual bad debt expenses. Feingold Dir., PGL Ex. RAF-1.0, 37:725-732; NS Ex. RAF-1.0, 34:734-741.

Aside from certain mitigation measures that address bad debt that has already accumulated, which the Utilities have aggressively pursued, there is little that can be done to reduce bad debt levels. *See* Feingold Dir., PGL Ex. RAF-1.0, 38:745-752; NS Ex. RAF-1.0, 35:756-763. It is simply indisputable that the circumstances that have given rise to the order of magnitude and more volatile nature of bad debt experienced by the Utilities are caused by events that are almost entirely out of the control of the Utilities. Further, the static rate methods that have been historically employed render it largely impossible for Utilities to protect themselves financially. *See* Feingold Dir., PGL Ex. RAF-1.0, 37:734-738; NS Ex. RAF-1.0, 34:744-749.

Additionally, the Utilities have demonstrated that the financial marketplace has recognized the negative financial impacts of bad debt expense and the need for regulatory relief. *Id* at 38:755-39:768; 35:766-36:779. Mr. Borgard also has demonstrated in Peoples Gas Ex. LTB-1.5 and North Shore Gas Ex. LTB-1.4 that the Utilities' bad debt expense has dramatically increased.

Thus, uncollectible accounts are a rising and recurring business expense for the Utilities and are a reflection of economic conditions that exist from time to time, the level of gas commodity and delivery prices and the demographics of the Utilities' service territories. As a result, bad debt is uncontrollable, highly variable and unpredictable, with resulting negative financial consequences. The Utilities' proposed Rider UBA would provide them with the ability to recover the ongoing level of these unforeseeable and largely unavoidable bad debt expenses related to purchased gas costs.

To the extent that gas commodity prices fluctuate upward or downward and influence bad debt levels, Rider UBA will swiftly recognize any increases or decreases in bad debt levels caused by such price changes. *See* Feingold Dir., PGL Ex. 1.0, 39:781-40:792; NS Ex. 1.0, 36:792 - 37:803. Rider UBA itself is simply a monthly volumetric adjustment, to be applied to company supplied gas, to recover gas cost related bad debt expense. The adjustment would be computed by multiplying the uncollectible expense percentage approved in this rate proceeding by the forecasted Gas Charge revenues arising from the application of Rider 2 to be effected for the upcoming month and dividing by the applicable volumes for the same month, yielding the effective adjustment.

Any differences between billed revenues and uncollectible expenses under the Rider will be reconciled on an annual basis and amortized over a 10 month period, with the resulting adjustment added to customers' bills during that period. The Companies have also agreed to conduct an annual internal audit and to file a monthly report with the Commission, as well as an annual report in February of each year to determine the earlier discussed reconciliation adjustment. Grace Dir., PGL Ex. VG-1.0 REV, 44:973 - 45:996; Grace Dir., NS Ex. VG-1.0 3REV, 39:863 - 40:886. The test year uncollectible gas cost expenses to be recovered through Rider UBA are \$26.7 million and \$1.5 million dollars for Peoples Gas and North Shore, respectively. Grace Dir., PGL Ex. VG-1.0, 45:1006-1007; Grace Dir., NS Ex. VG-1.0 3REV,

41:896-897. Rider UBA will only pertain to the gas cost portion of the Utilities' bad debt expense. The Utilities propose to remain at risk for the portion of bad debt expense related to the non-gas cost bad debt expense. Hence, non-gas cost uncollectible expense would be recovered in base rates. In the event that the Commission does not approve Rider UBA, however, the Utilities would continue to include and recover total bad debt allowance in base rates. Ms. Grace has developed rates that reflect both eventualities. *See* NS-PGL Ex. VG 2.4-PGL, pages 1 and 2, and NS-PGL Ex. VG-2.4-NSG, pages 1 and 2.

Other Parties

[Insert]

North Shore / Peoples Gas' Response

The Utilities assert that no party has presented evidence that disputes that the level of uncollectible expense on the Utilities' systems is substantially greater than has historically been the case or presented evidence that the fluctuating and unpredictable bad debt expense can be reasonably managed without a Rider UBA type of mechanism. The only substantive criticism of Rider UBA that has been offered is that bad debt has stabilized and is not volatile in relation to operating expenses. This argument is simply beside the point and fails to recognize the direct link between purchased gas expenses and bad debt experience. The relationship between bad debt and operating expenses is irrelevant as to whether bad debt expenses are significant. \$26.7 million and \$1.5 million of gas cost-related bad debt are substantial amounts and cannot be dismissed out of hand.

The Utilities disagree that purchased gas expenses are "stable," not volatile. In addition, bad debt expenses are far more volatile than other operating expenses excluding gas costs. NS-PGL Ex. RAF-2.2. In addition, the relationship between bad debt and gas prices is undeniable. The unpredictability of gas costs, among other reasons, is one of the justifications for tracking gas costs in Rider 2. Bad debt should be accorded similar treatment and the Utilities' proposal to recover the gas cost portion of uncollectible expense is sound and reasonable. The demonstrated volatility of gas prices and the attendant level of bad debt are phenomena that did not exist at the time the Utilities filed their last rate cases, but clearly existed during the 10-year period subsequent to those filings. Such circumstances justify a departure from the prior practice of recovering uncollectible expense entirely through base rates.

The Utilities point out that, as with their other rider proposals, Rider UBA type mechanisms have been widely accepted across the country. The record is uncontroverted that numerous state regulatory commissions have approved uncollectible expense tracking mechanisms. At least 17 gas utilities in 10 states employ them. Feingold Dir., PGL Ex. RAF-1.0, 41:821-823; NS Ex RAF-1.0, 38:833-835. Thus, the Commission would not be departing from sound and respected regulatory policy by approving an uncollectible mechanism for the Utilities. Of course, as with the other rider proposals, witnesses Messrs. Brosch and Lazare oppose Rider UBA on the same rigid philosophical grounds as discussed in regards to Rider EEP and the same counterarguments apply.

Commission Analysis and Conclusion

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, the bad debt of the Utilities which is to be recovered under Rider UBA is volatile, fluctuates and is largely outside 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 criteria.

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.*, particularly the bad debt of the Utilities which 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. Mr. Borgard's evidence shows that from 1997 to 2000 bad debt trended downward for those four years and 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, represents the kind of costs that warrant rider treatment. 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. *See Citizens Utility Board, 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. Those arguments are unpersuasive. First, 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., Ex. RAF-1.0, 40:795-800. The Utilities would thus remain at risk for a portion of bad debt expense which would be a considerable incentive to manage bad debt effectively. The Commission finds that 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 and gas costs, both of which are outside the control of the Utilities. Therefore the Commission finds that is reasonable that gas cost related bad debt be recovered through a rider.

AG has argued that bad debt does not warrant rider treatment because, in AG's opinion, the costs involved are insubstantial. AG Init. Br. at 124. The Commission finds that there is no legal requirement that a cost be of a particular size before it can warrant rider treatment, but, in

any event, the amounts in question are substantial. AG also attempts to interject least cost considerations into the discussion of whether Rider UBA is appropriate though the discussion is unconvincing.

The Commission therefore finds that the cost which Rider UBA will recover meets the requirements that warrant rider treatment and the Commission approves the implementation of Rider UBA.

F. Deferred Accounting Alternative to Certain Rider Requests

North Shore / Peoples Gas

The Companies proposed Riders VBA, UVA, and EEP as discussed above. In response to the direct testimony of Mr. Brosch regarding Rider EEP (GCI Ex-MLB-1.0, pp. 72-73), Ms. Grace testified that the Companies would accept, as an alternative to these three rider mechanisms in the event that the Commission determines one or more of them is too administratively complex and burdensome, to instead track the revenues and costs underlying the proposed Riders in deferral accounts, for later refund or adjustment to base rates as determined on an annual basis. Grace Reb., NS-PGL Ex. VG-2.0, pp. 50-51.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Companies responded to allegations by Staff and certain parties that such deferrals are inconsistent with test-year principles by distinguishing the revenues and costs underlying Riders VBA, UBA and EEP from the types of operating expenses for which the Commission, and the Illinois courts, have found to be violative of the Commission's test-year principles or that would result in overstatement of the Companies' revenue requirement "by mismatching low revenue from one year with high expense data from a different year." *BPI II*, 585 N.E.2d at 1058.

Commission Analysis and Conclusion

The Commission in this instance is convinced that the requested deferrals are an appropriate alternative to Riders VBA, UVA, and EEP. In each case, there does not appear to be a risk that tracking these particular revenues and costs in a deferral account "inaccurately portray[s] a higher need for rate increases." *CUB*, 651 N.E.2d at 1103. Instead, as the Companies point out, these deferrals will allow the Companies to "match costs incurred with revenue realized," *id.*, and thereby 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 the court in *BP II*.

While deferrals are not routinely permitted, the Commission finds under the particular circumstances of this proceeding that it is proper to exercise its discretionary authority which, as recognized by the courts since *BP II*, contemplates approval of mechanisms such as the deferral tracking proposed here. *See, e.g., Illinois-American Water Co.*, Docket No. 02-0690 at *169 (Aug. 12, 2003) (deferral may be appropriate despite *BP 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”).

Finally, the Commission finds that approval of the requested deferral tracking mechanism as an alternative to Rider EEP is particularly appropriate given the wide support for the efficiency programs that will be funded, the proposal of which was also widely supported in the Reorganization proceeding.

The Commission therefore finds that the tracking of revenues and costs underlying the proposed Riders VBA, UBA and EEP in deferral accounts, for later refund or recovery on an annual true-up basis, is reasonable, and approves such mechanism as proposed by the Companies.

VIII. COST OF SERVICE

A. Overview

The Companies have presented comprehensive and well reasoned Embedded Costs of Service Studies (“ECOSS”) sponsored by their witness, Mr. Amen. The ECOSS studies presented by Mr. Amen are detailed and consistent with well settled principles of cost classification, cost allocation and cost causation. The ECOSS for Peoples Gas is set forth in PGL Exs. RJA-1.1, 1.2 Rev. - 1.4, 1.7 Rev. - 1.8, 1.9 Rev., and 1.10 REV and North Shore’s is set forth in NS Exs. RJA-1.1, 1.2 Rev. - 1.4, 1.7 Rev. - 1.8, 1.9 Rev., and 1.10 REV.

The ECOSS reasonably establish cost responsibility among the various customer classes served by each of the Companies, and clearly match cost causation with the customers who cause each particular cost, thereby following the sound theoretical principle that cost incurrence should follow cost causation. The Companies were the only parties who submitted ECOSS in these proceedings. Staff witness Mr. Luth did make certain proposed adjustments to the ECOSS using the Companies’ ECOSS models. In addition, Staff the AG and City-CUB made selective criticisms of aspects of the ECOSS, but none of those parties took issue with the Companies’ broader ECOSS methodology or approach.

The contested ECOSS issues include (a) whether common system distribution costs should be allocated on the basis of the Coincident Peak (“CP”) method proposed by the Companies versus the Averages and Peak (“A&P”) method favored by Staff; (b) whether Account No. 904 should be classified as customer costs as proposed by the Companies; (c) whether S.C. No. 1 should be bifurcated into heating and non-heating customers, as proposed by the Companies but opposed by GCI; (d) whether Account No. 385 costs should be directly assigned, as proposed by GCI but as opposed by the Companies; (e) whether differentiating rates of return by class, opposed by the Companies but proposed by City-CUB, is reasonable; and (f)

whether the EPEC methodology proposed by the Companies for allocating overall revenue requirement among the various customer classes is appropriate.

B. Embedded Cost of Service Study

1. Uncontested Issues

a. Functionalization of Intangible Plant Account Nos. 303.1 and 303.2

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Companies agreed to Staff witness Mr. Luth's proposal to functionalize Accounts 303.1 and 303.2 costs as customer accounts and distribution-related, with the remaining amounts to be spread ratably among the functions to reflect the general and administrative uses of the remaining software and systems applications. Amen Reb., NS-PGL Ex. RJA-2.0, 11:237-240; NS-PGL Ex. RJA-2.3.

Commission Analysis and Conclusion

The Commission finds the Staff's final proposal, that the Companies functionalize Accounts 303.1 and 303.2 costs as customer accounts and distribution-related, with remaining amounts to be spread ratably among the functions to reflect the general and administrative uses of the remaining software and systems applications, is not opposed by any party, is reasonable and is appropriate. The Commission therefore approves such proposal.

b. Classification of Distribution Plant Account No. 375

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Companies agreed to Staff witness Mr. Luth's proposal that Account No. 375 be classified entirely as a demand-related cost rather than a combination of other costs, including customer costs. Amen Reb., NS-PGL RJA-2.0, 12:256-257; Amen Reb., NS-PGL RJA-2.3 and NS-PGL RJA-2.4.

Commission Analysis and Conclusion

The Commission finds the Staff's final proposal, that the Companies classify Account No. 375 entirely as a demand-related cost, is not opposed by any party, is reasonable and is appropriate. The Commission therefore approves such proposal.

2. Contested Issues

a. Coincident Peak Versus Average and Peak Allocation Methods

North Shore / Peoples Gas

The Companies' ECOSS are detailed and reflect well-founded principles and cost dynamics as well as the specific characteristics of their systems. The Companies' preferred methodology for the allocation of system demand costs is the Coincident Peak ("CP") methodology, based on the Peak Demand Design days of their respective systems, which the Companies believe is most appropriate in view of the specific characteristics of their respective systems and the principle of allocating costs to customers on a causal basis. For demonstrative purposes, two other options were considered by the companies in their ECOSS: (1) a CP method which classifies a portion of the distribution mains as customer-related costs, and (2) an Average and Peak ("A&P") approach.

Because the Companies' investment in their distribution systems is sized to meet peak demands so that they have the ability to meet their respective service obligations throughout the year, the Companies believe the CP method produces the most conceptually sound and balanced outcome. A Peak Demand Design Day methodology directly measures the gas demand requirements of the Companies' firm service customers who create the need for the Companies to acquire resources, build facilities and incur millions of dollars in fixed costs on an ongoing basis. Amen Dir., PGL Ex. RJA-1.0, 21:456-458, NS Ex. RJA-1.0, 21:459-462. Further, the use of this methodology to allocate system demand costs is the most reasonable approach because it is related to the actual system as it was built to serve customers' specific needs. Hence, this ECOSS methodology is the best way to capture the true cost causative factors of the Companies' operations.

Finally, Mr. Amen also testified that this methodology is almost always utilized when designing a gas distribution system to accommodate the gas demand requirements of customers served by the system. Amen Dir., PGL Ex. RJA-1.0, 19:419-421; Amen Dir., NS Ex. RJA-1.0, 19:422-424.

Other Parties

[Insert]

North Shore / Peoples Gas Response

Neither Mr. Luth on behalf of the Staff, nor Mr. Thomas on behalf of CUB-City, sufficiently explain why the A&P method is a more appropriate methodology for allocation of the Companies' system demand costs. Neither Mr. Luth nor Mr. Thomas explains how the A&P method, particularly its focus on average usage over peak usage, accurately reflects or relates to how the Companies' systems were built. Instead, Staff provides conclusory statements that a "significant amount" of distribution costs are not affected by peak demand considerations, while Mr. Luth's support for A&P is based on his generic belief that average deliveries are a relevant consideration.

The proponents of the A&P methodology failed to address how a utility's system, if sized only to accommodate average gas demands, would be able to meet peak system demands, or why under the circumstances the Commission should deviate from its (and the industry's) norm of using the CP methodology. In the absence of detailed and persuasive analyses indicating why the A&P methodology should be adopted for either or both of their systems, the CP method should be approved because it has been supported with sound reasoning and analysis.

Commission Analysis and Conclusion

The Commission rejects the proposals of Staff witness Mr. Luth and CUB-City witness Mr. Thomas to adopt the A&P method for demand cost allocation, or to otherwise deviate from the CP methodology proposed by the Companies. Both Mr. Luth and Mr. Thomas fail to explain how the A&P method, particularly its employment of average usage, relates to how the Companies' systems were built. They also fail to address how a utility's system, if sized only to accommodate average gas demands, could be able to meet peak system demands and why giving recognition to system utilization addresses the principle of cost causation. Indeed, sizing a gas system to meet only average load demands could be determined by this Commission to be imprudent behavior, given the Companies' statutory duty to satisfy the maximum day demand of all customers in their respective service territories – a level of demand which, by definition, will be experienced only one day per year. Finally, just as with the Companies' rate design proposals described and approved below, the Commission agrees with the Companies that it is imperative to match costs with the customers who cause them, and to allocate them in such causal manner in order to send proper signals and well as to ensure that service costs are fair and reasonable. Therefore, in the absence of detailed analyses and credible arguments as to why the A&P method should be adopted for the Companies' systems, the Companies' proposed use of the CP method is approved by the Commission because it has been supported with both sound reasoning and adequately detailed analysis in the record.

b. Classification of Uncollectible Account Expenses Account No. 904

North Shore / Peoples Gas

In their ECOSS, the Companies classified expenses recorded in Account No. 904, Uncollectible Account Expenses, as customer costs.

Other Parties

[Insert]

North Shore / Peoples Gas Response

While Staff witness Mr. Luth testified that such expenses should be classified more broadly as customer costs, demand costs and commodity costs, neither Staff nor any other party briefed this issue. The Companies' replied that Account No. 904 costs are a function of customers' failure to pay their bills, rather than a function of the underlying components of the rates underlying such unpaid bills. The uncollectible expenses have no bearing on whether the expenses are fixed or variable charges or the specific costs which may be covered by those bills.

Residential customers do not even receive fully allocated costs. Amen Reb., NS-PGL Ex. RJA-2.0, 13:278-282. Hence, any attempt to match the recovery of uncollectible expenses to specific charges is misplaced because the amount of uncollectible expense (or any other expense) that is recovered (or not) by the customer demand, distribution and commodity charges of a particular service schedule cannot be determined with any certainty. Amen Sur., NS-PGL Ex. RJA-3.0, 6:123-128.

Commission Analysis and Conclusion

The Commission rejects Staff witness Mr. Luth's proposal that Account No. 904 expenses should be classified as a combination of customer costs, demand costs, and commodity costs including gas costs. The Commission also rejects Mr. Luth's proposal to apportion the uncollectible expense in each customer class to the respective demand, customer and commodity classifications by the relative weight or percentage of revenue requirement from each customer class resulting from various categories of costs.

The amount of uncollectible expense, or any other expense, recovered by the customer demand and distribution charges of a particular service schedule is uncertain since the revenues produced by any service classification are not necessarily equal to their fully allocated costs. Further, the customer, demand and commodity related costs for a particular service classification are not translated directly into matching rate components in the Companies' rate schedules. Accordingly, the Commission rejects Staff witness Luth's recommendations because they inappropriately use rate design as justification for cost classification and allocation in an ECOSS.

Therefore, the Commission approves, as reasonable and appropriate, the Companies' classification of expenses recorded in Account No. 904, Uncollectible Account Expenses, as customer costs.

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

North Shore / Peoples Gas

The Companies' proposal to bifurcate S.C. No. 1 into heating (S.C. No. 1H) and non-heating (S.C. No. 1N) categories is reasonable and supported by the evidence presented by the Companies. The Companies have established that bifurcating S.C. No. 1 will allow for better alignment of costs and revenue recovery, and also provide more equity between and within rate classes, by setting rates closer to the costs of service. Grace Dir., PGL Ex. VG-1.0 REV, 11:230-232, NS Ex. VG-1.0 3REV, 9:191-193. The Utilities' ECOSS shows a significant difference in fixed costs for heating and non-heating customers. The fixed costs for heating customers are twice as high as those of non-heating customers. A single service classification for heating and non-heating customers would slow the movement of non-heating customers toward cost-based service rates. Grace Dir., PGL Ex. VG-1.0 REV, 11:232-237, NS Ex. VG-1.0 2Rev., 9:193-197.

The Utilities have shown that they have properly classified customers into heating and non-heating designation. The Utilities have attached such designations to their small residential accounts for at least twenty years. These designations have been made based on information provided by the customers at the time service commenced or in follow-up calls from the Companies, through service inspections and through billing department analyses of customer

account usage. The Utilities have also submitted evidence showing that 97% of Peoples Gas' and 91% of North Shore's S.C. 1N monthly bills are for 50 therms or less, which supports the assumption that S.C. 1N customers generally use less than 500 annual therms and that heating customers would be expected to use more than 500 therms a year. Furthermore, the Utilities have demonstrated that usage is one of a few important factors that would be considered to ensure that customers are properly classified. Grace Reb., NS-PGL Ex. VG-2.0, 32:673-696.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Companies replied that dividing S.C. No. 1 customers into multi-family and single family classes, as proposed by GCI witness Mr. Glahn, would do nothing to help recognition of the fact that heating customers place a significantly higher peak load on the system than do non-heating customers. Amen Sur., NS-PGL Ex. RJA-3.0, 8:163-175.

It is also undisputed that under their current rate structures, an intra-class subsidy from the Companies' heating customers to non-heating customers exists, and that the single rate for heating and non-heating customers slows the movement of non-heating customers' rates toward cost. Grace Dir., PGL Ex. VG-1.0 REV, 11:232-237, NS Ex. VG-1.0 2Rev., 9:193-197. The Companies also demonstrated that fixed costs for heating customers are twice as high as those for non-heating customers, and that such a significant difference would result in the recovery of fixed costs through fixed charges under a single rate which could overburden small non-heating customers. Grace Dir., PGL Ex. VG-1.0 REV, 11:241-246; NS Ex. VG-1.0 3REV, 9:201-10:205.

Even Mr. Glahn, the only witness to oppose the bifurcation itself, admits to only having problems with the Utilities' implementation of the bifurcation, and he further admits that the Companies' proposed heating and non-heating distinction is "common in the industry". Glahn Dir., GCI Ex. 3.0 REV, 16:1-2. Mr. Glahn's perceived implementation problems are that: (1) the proportion of costs assigned to heating customers appears "implausibly" high; (2) rates disproportionately impact low and fixed income customers; (3) there will be little shift in the subsidy of non-heating customers by heating customers under the Companies' proposal. *Id.*, at 16:3-8. Each of these issues is without support in the record.

First, Mr. Glahn's assertion that the cost differentials between S.C. No. 1 and S.C. No. 1N are "implausibly high" is irrelevant and in any event is based upon flawed analysis. His "average per customer" calculations for service plant ignore the fact that multiple residential heating customers are served by shared gas service lines, a predominant circumstance on the Peoples Gas system. Amen Reb., NS-PGL Ex. RJA-2.0, 15:325-336. Peoples Gas' ECOSS properly accounts for the sharing of service lines by multiple customers. Amen Reb., NS-PGL Ex. RJA-2.0, 16:339-353. Mr. Glahn also inaccurately generalizes that multi-family units spread fixed costs over a larger customer base driving down costs per customer, which is simply unsupported. Glahn Reb., GCI Ex. 6.0 REV, 4:84-86. Instead, the Companies' bifurcation into heating and non-heating classes appropriately recognizes customers' respective load characteristics by reflecting the single largest component of distribution plant which drives cost

responsibility, *i.e.*, the cost of mains. The capacity cost of mains is driven by peak load and, as a group, heating customers place a significantly higher peak load on the system than do non-heating customers. Dividing S.C. No. 1 customers into multi-family and single family classes would not assist in the recognition of this important cost causation factor. Amen Sur., NS-PGL Ex. RJA-3.0, 8:163-175.

Second, Mr. Glahn's criticism that the 1N/1H bifurcation disproportionately impacts low income customers, Glahn Dir., GCI Ex. 3.0 REV, 17:19 - 18:2, is unavailing. As established by Ms. Grace, the rates that would result under the Companies' bifurcation proposal would be lower than those proposed by Mr. Glahn, particularly during the winter. Grace Reb., NS-PGL Ex. VG-2.0, 33:714-719.

Finally, Mr. Glahn's assertion that bifurcation is not needed because there is no shift in the subsidy of non-heating customers by heating customers also lacks merit. A primary purpose of bifurcation is to better align costs and revenue recovery. Grace Dir., PGL Ex. VG-1.0 REV, 11:230-237; Grace Dir. NS Ex. VG-1.0 3REV, 9:191-197. Because the fixed costs for S.C. No. 1H are twice as high as the fixed costs for S.C. No. 1N, the current single service rate structure does not appropriately align costs with their causal factors and thus smaller use, non-heating customers are overburdened. Grace Dir., PGL Ex. VG-1.0 REV, 11:241-244; Grace Dir., NS Ex. VG-1.0 3REV, 9:200 - 10:204. Mr. Glahn supports his assertion by comparing the difference between the cost recovery percentages of S.C. No. 1 and S.C. No. 1N before and after the proposed rate increase (8.38% and 8.3%, respectively), and concluding that since the differences between the percentages remain basically the same before and after the proposed rate increase, bifurcation of S.C. No. 1 is unwarranted. Glahn Dir., GCI Ex. 3.0 REV, 23:6-10. Mr. Glahn's simplistic comparison proves nothing in respect of the appropriateness of bifurcation, nor does it address or refute Ms. Grace's testimony establishing that the proposed bifurcation does not by itself result in higher rate increases for heating customers, contrary to Mr. Glahn's assertion. Grace Reb., NS-PGL Ex. VG-2.0, 33:724 - 34:728.

Mr. Luth did not indicate that he opposes the Companies' bifurcations. However he did put forth proposals to determine customers' eligibility for S.C. Nos. 1N and 1H. His initial proposal was problematic for a variety of reasons. Grace Reb., NS-PGL Ex. VG-2.0, 26:545 - 31:672. In response to the litany of problems associated with his initial proposal, Mr. Luth replaced that proposal with a new proposal which does not eliminate those already identified problems and in fact introduces many new problems. Grace Sur., NS-PGL Ex. VG-3.0, 7:144 - 9:197. Mr. Luth has not demonstrated that his proposals are warranted, practical or workable.

Commission Analysis and Conclusion

The Commission finds that the proposed recommendations of GCI witness Mr. Glahn are not supported by the evidence. He asserts that the heating and non-heating distinction is "common in the industry" yet he opposes the Companies' bifurcation proposal because of his belief that the cost differentials between S.C. No. 1H and S.C. No. 1N are "implausibly high." But the Companies demonstrated that Mr. Glahn's simplistic analysis has no bearing on whether the Companies proposed bifurcation is appropriate, and further that Mr. Glahn's suggestion that a multi-family versus single family bifurcation might be appropriate is also unsupported by the facts. Mr. Glahn's average per customer calculations for service plant ignore the occurrence of

multiple S.C. No. 1N customers served by shared gas service lines, while the Companies' ECOSS properly account for the sharing of service lines by multiple customers.

The Companies' bifurcation of S.C. No. 1 into heating and non-heating classes appropriately recognizes those customers' respective load characteristics by reflecting the single largest component of distribution plant which drives cost responsibility, *i.e.*, the cost of mains. The Commission is unconvinced that dividing S.C. No. 1 customers into multi-family versus single family classes, as proposed by Mr. Glahn, would help to recognize cost causation as does the Companies' heating versus non-heating classification proposal.

Mr. Glahn's criticism that the 1N/1H bifurcation disproportionately impacts low income customers also lacks support in the record. The Companies have established that their bifurcation proposal will actually result in lower rates, especially in the winter, than Mr. Glahn's proposal. Finally, both the Companies and Mr. Glahn agree that a subsidy from heating to non-heating exists; but Mr. Glahn's conclusion, that the lack of significant change in nominal percentages before and after the proposed bifurcation, is not a sufficient basis in context of a base rate case proceeding to reject the Companies' S.C. No. 1 bifurcation proposal in light of the justifications for such proposal provided by the Companies in the record.

The Commission is also convinced that the bifurcation-related concerns raised by Staff witness Luth, as well as the proposals he offered, should be rejected for the reasons stated by the Companies. In any event, Staff did not adequately respond to the issues raised by the Companies regarding his proposals and concerns.

The Commission finds that the Companies have adequately demonstrated that their proposed bifurcation will not result in higher rate increases for heating customers, that the current single service rate structure of the Companies overburdens smaller use non-heating customers, and that the proposed bifurcation of S.C. No. 1 is reasonable. The Commission therefore accepts and approves the Companies' proposal to bifurcate S.C. No. 1 as fair and reasonable.

d. Allocation of Distribution Plant Account No. 385

Peoples Gas

Peoples Gas allocated the majority of Account No. 385 costs, which represent industrial measuring and regulating station equipment expense, to S.C. No. 2.

Other Parties

[Insert]

Peoples Gas' Response

It is undisputed that: (1) Peoples Gas can track FERC Account No. 385 costs to individual customers; (2) customers that cause Peoples Gas to incur costs recorded in Account No. 385 may migrate from one rate classification to another; and (3) the number of customers who cause Peoples Gas to incur such charges is small. NS/PGL Ex. RJA-2.0 at 17-18, L. 376-

87; *see also* Sep. 10, 2007 Tr. at 324-25. But these facts do not support Mr. Glahn's various proposals.

The AG similarly offers no authority for its position that there is an "overriding preference" for direct assignment of costs. Instead, the AG joins GCI in 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 testified, 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 Companies. Instead, the Companies propose that a sound rate structure should include the practical attributes of simplicity, understandability, certainty and feasibility of application. Amen, Sur., NS-PGL Ex. RJA-3.0, 10:223-11:231.

Commission Analysis and Conclusion

The only witness that objected to Peoples Gas' proposal is GCI witness Mr. Glahn, who initially proposed that Account No. 385 expense be allocated entirely to S.C. No. 4 because S.C. No. 4 best fits the definition of Large Industrial. He also suggested that S.C. No. 5³ might also be a repository for such costs. After Peoples Gas indicated that Mr. Glahn's assumptions that the Company could not track all Account 385 costs was not the case, Mr. Glahn changed his approach and proposed that Account 385 costs should be directly charged as a facilities charge or metering surcharge to the individual customers generating those costs because the Company can track the costs of Account No. 385 facilities to individual customers; the customers may move from one rate classification to another; and the small number of customers causing the cost justifies a direct charge.

The Commission believes that such an alternative approach would be impractical and inappropriate. Applying Peoples Gas' methodology, the Account No. 385 expenses would increase the S.C. No. 2 Meter Class No. 1 charge by \$0.05, and the Meter Class No. 2 charge would decrease by \$0.13. Thus, the overall impact of the issue Mr. Glahn raises is extremely small -- Account No. 385 represents less than 0.04% of Peoples Gas' customer related distribution plant. Moreover, Mr. Glahn's proposal raises questions of fairness and equity with respect to the treatment of customers whose costs can be specifically identified to them. The Commission agrees that the Companies have the capability to identify the specific plant costs of meters, regulators and services with individual customers in all of its service classes; however, we believe this would create a multiplicity of charges, and an impractical rate approach. To the extent practicable, a sound rate structure should include the practical attributes of simplicity, understandability, certainty and feasibility of application. Thus, the Commission approves Peoples Gas' proposal as fair, reasonable and appropriate.

³ Although Mr. Glahn cited S.C. No. 5, it appears his intent was to refer to S.C. No. 6 (standby service).

e. **Differentiated Class Rates of Return**

North Shore / Peoples Gas Response

The Companies have met the requisite statutory burden with respect to their proposed allocation of the revenue requirement. The Companies calculated, at present rates, an average return in their respective ECOSS' of 4.88% for Peoples Gas and 7.12% for North Shore. Amen Dir., PGL Ex. RJA-1.0, 33:740; NS Ex. RJA-1.0, 33:697. The Companies' witness, Mr. Amen, testified that his ECOSS allocates revenue responsibility at an equalized class rate of return on investment of 8.25% for Peoples Gas, and 8.57% for North Shore, under proposed rates. Amen Dir., PGL Ex. RJA-1.0, 2:28-31; NS Ex. RJA-1.0, 2:27-30.

Other Parties

[Insert]

North Shore / Peoples Gas Response

City-CUB witness Mr. Thomas was the only witness to interpret the Companies' ECOSS methodology as assuming that each customer class contributes in precisely the same way to the Companies' required rate of return. In addition, Mr. Thomas suggests that residential customers' gas usage is affected by the weather, while commercial customers' usage is affected by economic conditions, and he therefore concludes that each customer class must provide a different level of risk to the overall cash flow risk of the Companies and that each should pay rates which are established under separate rate of return assumptions. Mr. Thomas made no effort to support his observation with an analysis of these purported different risks. Indeed, he admitted that he was not even proposing any specific adjustments, but merely making an observation to cast doubt on Mr. Amen's ECOSS results. Thomas Dir., CUB-City Ex. 1.0, 77:1876-78:1878.

The AG urges that the Companies failed to carry their burden of proof on this issue, but the Companies urge that their burden 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 submit that they have done so.

Commission Analysis and Conclusion

The Commission disagrees with the analysis and arguments of the AG and Mr. Thomas. The Commission finds that absent some demonstrated causal link between a utility's customer class composition and its capital costs, the concept of relative customer class risk is inapplicable as a basis for setting customer class target rates of return within the framework of a cost of service study such as the ECOSS submitted by the Companies in this proceeding. Therefore, the Commission accepts and approves the Companies' rate of return proposals as fair and reasonable.

f. Allocation of Revenue Requirement to Customer Classes

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Companies replied to Mr. Thomas' "cautionary" statements by pointing out that they never suggested that the Commission should rely solely upon their ECOSS for the purposes of designing rates. The Companies also have not suggested that other factors are irrelevant to the revenue allocation process. However, in the absence of any alternative approaches offered into the record by any other party, the Companies submitted that their ECOSS stands as the most reasonable basis for establishing cost responsibility among the customer classes.

Mr. Glahn's criticism of the Companies' use of the EPEC methodology is similarly unfounded and unsupported by any alternative approach that he or any other witness offered into the record. Mr. Glahn never explained why he believes that the customer class groupings under the EPEC method are arbitrary, instead he simply recited the method's revenue cost ratio effect and allocated additional costs to one service classification (S.C. No. 4, which is established at cost) and to another (S.C. No.7, where contractually established rates already reflect the appropriate cost considerations) without any explanation or apparent basis.

Finally, Mr. Glahn's methodology is mathematically incorrect and results in an increase which is \$533,971.00 higher than that proposed by Peoples Gas. *See* Ex. EG-2.2, pg. 1, columns A and D and GCI Ex. 3.0, Ex. WLG-D, Schedule 2, column (4).

Commission Analysis and Conclusion

The Commission declines to accept Mr. Thomas' cautionary statements, and rejects Mr. Glahn's testimony on this issue as inconsistent with Peoples Gas' and Staff's goals of setting S.C. No. 4 at cost rather than above cost, and of preventing the improper over-allocation of costs to S.C. No. 7. Instead, the Commission accepts the Companies' proposal as fair and reasonable and, therefore, approves the use of their respective ECOSS for the purpose of designing rates in this proceeding as proposed by the Utilities.

IX. RATE DESIGN

A. Overview

The Utilities have not filed a rate case since 1995, and the current tariff book was created that year. The tariff books submitted by the Utilities in these proceedings are completely new and have been submitted as IL.C.C No. 28 and IL.C.C No. 17 for Peoples Gas and North Gas, respectively. *See* Grace Dir., PGL Ex. VG-1.1 and NS Ex. VG-1.1. In designing rates, the Utilities have sought to accomplish six major objectives. They are to (1) better align costs and revenue recovery, (2) provide more equity between and within rate classes, (3) maintain rate design continuity, (4) reflect gradualism, (5) retain customers on the Utilities' systems and (6) consolidate certain transportation riders while providing new service options for transportation customers. Grace Dir., PGL Ex. VG-1.0 REV, 4:68-72; NS Ex. VG-1.0 2REV, 4:68-72.

Objectives 1 through 5 will be addressed in this Section IX and objective 6 will be addressed in Section X, below.

The Utilities have presented analyses that reflect their revenues under present and proposed rates with Rider UBA. *See* Grace Dir., PGL Ex. VG-1.1; NS Ex. VG-1.2. These exhibits also reflect the proposed transportation diversity factors of .87 and .75 for transportation customers of Peoples Gas and North Shore, respectively. *See* Grace Dir., PGL Ex. VG-1.0 REV, 5:88; NS Ex. VG-1.0 2REV, 5:88 and PGL Ex. VG-1.2, 1; NS Ex. VG-1.2, 1.

The Utilities have submitted additional exhibits which show rate and revenue impacts with Rider UBA expenses recovered through base rates, rather than through a rider mechanism. *See* Grace Dir., PGL Ex. VG-1.0 REV, 5:90-94; NS Ex. VG-1.0 3REV, 5:90-93 and PGL Ex. VG-1.2, page 2 and NS Ex. VG-2.1, page 2. Rider UBA places recovery of the gas cost portion of uncollectible expense in a rider rather than base rates.

If the Commission does not approve Rider UBA, the Companies' base rates must include the full uncollectible expense, including that portion that would have been recovered through the rider. Accordingly, the Companies' rate and revenue data reflect the preferred rate design, which includes Rider UBA as well as rate and revenue data with uncollectible expense in base rates without Rider UBA.

The Utilities utilized Mr. Amen's ECOSS as the basis for the determination of the revenue requirement and resulting proposed rates in this proceeding, including the analyses without Rider UBA. The Companies used the ECOSS to move rates toward cost-based rates and to better align charges with like costs.

The ECOSS was also used as the basis for bifurcating Service Classification No. 1 into two new service classifications: S.C. No. 1N, Small Residential Non-Heating Service, and S.C. No. 1H, Small Residential Heating Service. Grace Dir., PGL Ex. VG-1.0 REV, 6:112-117, NS Ex. VG-1.0 3REV, 6:111-116. Utilizing the ECOSS results which determine the cost of service for each service classification, North Shore proposes to continue to set all its service classifications at cost. Peoples Gas proposes to set all service classifications, except S.C. Nos. 1N, 1H, and 2, at cost. The remaining revenue requirement for S.C. Nos. 1N, 1H and 2, is allocated utilizing the equal percentage of embedded cost ("EPEC") methodology which is discussed in more detail in section B(1) of this Section IX. Almost all of the Utilities' costs, about 95% for Peoples Gas and about 98% for North Shore are fixed, *i.e.*, they do not vary with throughput. However, the Utilities have traditionally recovered a greater portion of their costs through non-fixed volumetric charges. The Utilities' last rate case filed about 12 years ago reflected costs that were 98% and 97% fixed for Peoples Gas and North Shore, respectively. Less than 30% of fixed costs were recovered through fixed charges. *See*, Dockets Nos. 95-0031 and 95-0032.

This mismatch of fixed costs and non-fixed charges practically assures that the Utilities will either over or under-earn their Commission approved revenue requirement and that customers will either over or under pay their share of such costs. To partially remedy this, the Utilities are proposing to recover more fixed costs through fixed charges. Grace Dir., PGL Ex. VG-1.0 REV, 8:168-9:184; NS Ex. VG-1.0 3REV, 6:130-7:144.

Generally the Utilities have proposed to increase customer charges in an effort to better align costs and revenue recovery. The relative increase in customer charges proposed by the Utilities is consistent with a growing trend whereby public utility commissions have approved greater fixed cost recovery in fixed charges. This trend has resulted in the approval of rate models where all fixed cost are recovered through a fixed charge, such as the Straight Fixed Variable “SFV” rate design whereby customers pay a largely flat charge for utility delivery service, with little or no volumetric charge. *See Re Atlanta Gas Light Company*, 2001 WL 1776861 (Ga. P.S.C., Sep 18, 2001) (Docket No. 8516-U).

Greater fixed cost recovery through customer charges stabilizes the non-gas cost delivery charge portion of customers’ bills and stabilizes the variability in earnings related to variations in customer consumption caused by weather and other conditions outside the Utilities’ control. While the Utilities have demonstrated that an SFV rate design would be the optimal one, PGL Ex. VG-1.0 REV, 17:360-18:388; NS Ex. VG-1.0 3REV, 14:309-15:337, the Utilities, instead, are proposing only to recover a greater portion of fixed cost through increased customer charges.

Other parties to these proceedings have not submitted evidence that the Utilities’ move toward greater fixed cost recovery through higher customer charges is unwarranted. Rather, those parties have taken issue with specific aspects of the Utilities’ S.C. No. 1N and S.C. No. 1H proposals. The Commission has urged Peoples Gas to increase its customer charge in future rate proceedings to move it closer to cost. *Re Peoples Gas Light and Coke Company*, 1995 WL 17200632 (Ill.C.C. Nov 8, 1995) (Docket No. 95-0032). The Companies’ proposals are consistent with this policy. The particulars of the rates and rate design proposals of the Utilities and other parties are discussed below.

Generally, as to Peoples Gas, the Company has proposed ten major changes to its base rates and other charges. These are the following:

1. S.C. No. 1, Small Residential Service, will be bifurcated into two service classifications: S.C. No. 1N, Small Residential Non-Heating Service, and S.C. No. 1H, Small Residential Heating Service.
2. The monthly customer charge for S.C. No. 1N customers will be increased. The distribution charge, which is a two-block rate structure under current S.C. No. 1, will become a flat charge.
3. The monthly customer charge for S.C. No. 1H customers will be increased. The distribution charge will reflect a decrease in the end block with a greater percentage of costs being allocated to the front block of the current two-block rate structure.
4. The monthly customer charges for each Meter Class under S.C. No. 2, General Service, will be increased. The distribution charge will reflect an increase in the front and middle blocks and a decrease in the end block of the three-block rate structure.

5. S.C. No. 3, Large Volume Service, and S.C. No. 4, Large Volume Demand Service, will be combined under S.C. No. 4. S.C. No. 3 will be eliminated. The monthly customer charge and demand charge will be decreased. The distribution charge and standby service charge will be increased. This service classification is set at cost.
6. The monthly customer charge and distribution charge for S.C. No. 6, Standby Service, will be increased. The demand charge will be decreased and will reflect a single demand charge rather than the separate demand charges for heating and non-heating customers under current rates. This service classification is set at cost.
7. The customer charge and distribution charge for S.C. No. 8, Compressed Natural Gas, will be increased. This service classification is set at cost.
8. Service reconnection charges and service activation charges will be restructured to reflect a base charge and charges for additional appliances.
9. The Charge for Dishonored Checks and/or Incomplete Electronic Withdrawal will be increased to better reflect prevailing rates for such checks and transactions and to discourage customers from making such deficient payments to the Company.
10. The Company is proposing a new charge for a Second Pulse Data Capability to accommodate customers' requests for this service. *See Grace Dir., PGN Ex. VG-1.0REV, 9:188-10:219.*

Generally, as to North Shore, the Company has proposed nine major changes to its base rates and other charges. These are the following:

1. S.C. No. 1, Small Residential Service, will be bifurcated into two service classifications: S.C. No. 1N, Small Residential Non-Heating Service, and S.C. No. 1H, Small Residential Heating Service.
2. The monthly customer charge for S.C. No. 1N customers will be increased. The distribution charge, which is a two-block rate structure under current S.C. No. 1, will become a flat charge. This service classification is set at cost.
3. The monthly customer charge for S.C. No. 1H customers will be increased. The distribution charge will reflect a decrease in the end block with a greater percentage of costs being allocated to the front block of the current two-block rate structure. This service classification is set at cost.
4. The monthly customer charges for each Meter Class under S.C. No. 2, General Service, will be increased. The distribution charge will reflect an increase in the front and a decrease in the middle and end blocks of the three-block rate structure. This service classification is set at cost.

5. The monthly customer charge, distribution charge, demand charge and standby service charge for S.C. No. 3, Large Volume Service will be decreased. The increased. The demand blocks for this service classification will be changed from 5,000 therms and over 5,000 therms to 10,000 therms and over 10,000 therms. This service classification is set at cost.
6. The monthly customer charge and distribution charge for S.C. No. 5, Standby Service, will be increased. The demand charge will be decreased. This service classification is set at cost.
7. Service reconnection charges and service activation charges will be restructured to reflect a base charge and charges for additional appliances.
8. The Charge for Dishonored Checks and/or Incomplete Electronic Withdrawal will be increased to better reflect prevailing rates for such checks and transactions and to discourage customers from making such deficient payments to the Company.
9. The Company is proposing a new charge for a Second Pulse Data Capability to accommodate customers' requests for this service. *See* Grace Dir, Ex. VG-1.0REV, 7:148-9:180. Only certain aspects of these proposals are contested, and they will be discussed below.

B. General Rate Design

1. Allocation of Rate Increase

North Shore / Peoples Gas

North Shore proposes to continue to set all its service classifications at cost. Peoples Gas proposes to set S.C. Nos. 4, 6 and 8 at cost and to allocate the remaining revenue requirement among S.C. Nos. 1N, 1H and 2 utilizing the equal percentage of embedded cost (EPEC) method. The EPEC method allocates the remaining revenue requirement in proportion to the embedded costs of service for the three service classifications and the resulting amounts are added to the revenue generated under currently applicable rates for the particular service classification to arrive at the revenue to be provided under proposed rates. Grace Dir., PGL Ex. VG-1.0 REV, 6:123-130; NS Ex. VG-1.0 3REV, 6:111-118.

The EPEC method provides a gradual movement toward full cost recovery for the small residential customer service classifications. It also provides a gradual movement toward equalizing rates of return for these service classifications. Grace Dir., PGL Ex. VG-1.0 REV, 7:134-139. It would appear that all parties support the notion that ideally, all service classifications should support their full cost of service.

For various historical and policy reasons, however, the rates of Peoples Gas' current small residential service classification has been set below cost. In order to avoid the rate spikes that would attend moving residential service classifications to costs Peoples Gas has employed

the EPEC method to promote gradualism in the movement toward full cost. The Commission has heretofore endorsed this approach with its approval of the EPEC method in Peoples Gas' last two rate cases. *See* Peoples Gas Light and Coke Co., Docket Nos. 91-0586 and 95-0032.

Other Parties

[Insert]

North Shore/Peoples Gas Responses

No party appears to quarrel with the notion of gradualism being employed in these proceedings. Rather, two witnesses appear to take issue with the rate increase allocations that result from application of the EPEC mechanism. Neither of those parties, or any other party, has proposed a method that is definable, supportable, and reasonable like the EPEC methodology, although a third party offers a vague alternative to Peoples Gas' proposal.

Mr. Luth takes issue with certain aspects of the Peoples Gas allocation of the proposed rate increase to customer classes. Mr. Luth proposes specific rates for S.C. Nos. 1N and 1H as well as a specific amount of the remainder of the S.C. Nos. 1N and 1H increase that would be allocated to S.C. No. 2 based on the revenue requirement that he determined. Mr. Luth's methodology for that allocation however, is flawed. Mr. Luth's proposal is driven by specific charges for S.C. Nos. 1N and 1H and a specific amount for the increase that would be allocated to S.C. No. 2 rather than an overarching method that could be readily and objectively applied to a revenue requirement that would differ from his own. While Mr. Luth achieves rate outcomes that may not be unreasonable, his methodology is not capable of being applied predictably and readily to the revenue requirement determined in this Order.

Mr. Glahn's sole basis for criticizing the Utilities' EPEC method is that he believes that it applies arbitrary customer class groupings. 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, and to set S.C. No. 4, which combines two similar service classifications, at cost. 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 only party that supports setting S.C. No. 4 over cost or allocating costs to S.C. No. 7. 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 offers no specific rate design proposals for either one. For all other reasons discussed herein, Mr. Glahn's proposals should be rejected.

Mr. Neil Anderson, on behalf of Vanguard Energy Services (“VES”), proposes to phase in increases for rate classifications to reach cost over a five (5) year period. Mr. Anderson’s proposal, however, is devoid of details. While Mr. Anderson characterizes his proposal as a rate design proposal, he does not offer any rates or meaningful rate design proposal for any service classification. His exhibit VES 3, which supports his “rate design proposal”, reflects revenue allocations for years 1 through 4 that are consistent with Peoples Gas’ EPEC revenue allocation. However, it is unclear how the revenue allocation in year 5 (Exhibit VES 3, line 9) was derived. It should also be noted that the service class revenues in year 5 (Exhibit VES 3, line 9) do not sum to the total company revenues and the total revenue amount is not consistent with any revenue amount proposed by any party in this proceeding. Peoples Gas agrees that it is appropriate to move all service classifications to cost, and it is taking significant steps in this case, including bifurcating S.C. No. 1 into heating and non-heating rates, to move S.C. No. 1 to cost. *See*, Grace Reb., NS-PGL Ex. VG-2.0, 17:367-18:379. However, Mr. Anderson’s proposal lacks sufficient detail for the Commission to evaluate and should be rejected.

Indeed, the rate increase allocation proposals for Peoples Gas by other parties appear to have been arbitrarily derived or are improper and none have been accompanied by analysis which would show the impact of their proposals on customers’ bills. In short, only Peoples Gas has provided a reasoned and specific analysis to support its rate increase allocation and only the Companies have shown how their specific rate proposals would affect customers.

Commission Analysis and Conclusion

Peoples Gas has proposed to allocate a portion of the S.C. No. 1N and 1H rate increases to S.C. No. 2 by utilizing the EPEC method. This methodology is not based upon any specific rates or rate design proposals. Instead, it is based upon a defined formula approved in Peoples Gas’ two prior rate cases which determines the amount of the small residential service classification rate increase that will be allocated to the S.C. No. 2 revenue requirement. The Commission finds that the method employed by Peoples Gas assures that the revenue requirement set forth in this Order will be readily and objectively allocated. The Commission is unable to ascertain if Mr. Luth’s methodology would readily adapt to a revenue requirement that differs from his own. Similarly, Mr. Glahn’s proposals for allocating the rate increase for Peoples Gas is too limited in scope and not based on a broadly applicable methodology. Mr. Glahn arbitrarily assigns an amount of the increase to S.C. Nos. 4 and 7 with insufficient reasoning. In the case of S.C. No. 7, customers receive service under binding negotiated contracts, and it is not clear how such costs could be factored into these contracts. Moreover, Peoples Gas has indicated that such contracts reflect the proper cost considerations. Mr. Glahn has not proven otherwise. Mr. Glahn has also offered no persuasive reason why S.C. No. 4 should be set above cost, since the record demonstrates that these customers have some ability to bypass Peoples Gas’ system. The Commission finds that it is reasonable to allocate a portion of the rate increase for S.C. Nos. 1N and 1H to S.C. No. 2 using the EPEC method proposed by Peoples Gas. While Mr. Anderson’s proposal raises some interesting ideas, the Commission is unable to analyze it or approve it for lack of sufficient detail.

2. Gas Cost Related Uncollectible Expense

North Shore/ Peoples Gas

The only issues which are contested concerning Gas Cost Related Uncollectible Expense center from a rate design perspective around how the gas cost related uncollectible expense would be recovered in base rates if Rider UBA is not approved. Staff Witness Mr. Luth is the only party who has taken issue on the record with the Utilities' proposals for the treatment of uncollectible expense if Rider UBA is not adopted. At one point, Mr. Luth had urged that uncollectible expense should be allocated to S.C. Nos. 3 and 4 and Peoples Gas performed an analysis that indicated a portion of bad debt was attributable to S.C. No. 3 and modified the proposals to allocate an appropriate amount to S.C. No. 4. See Amen Reb., NS-PGL RJA-2.0,14:294-302.

Other Parties

[Insert]

North Shore / Peoples Gas' Responses

Ms. Grace and Mr. Luth agree in principle that if Rider UBA is not approved, separate base rates will need to be established for sales and transportation customers. Ms. Grace has proposed an approach whereby the Utilities' ECOSS, which already reflects the removal of gas cost related bad debt expense, would establish the base rates for all customers, including transportation customers. The Gas Cost Related Uncollectible Expense would then be added to sales customer's distribution base rates, thereby establishing separate rates in a straightforward and simple manner. Exhibits VG-2.3-PGL and VG-2.3-NSG illustrate this simple methodology which determines how the Utilities' distribution base rates would be affected. Ms. Grace's approach also allocates uncollectible expenses at full costs to each affected service classification. Grace Reb., NS-PGL Ex. VG-2.0, 21:445-447. This is an appropriate approach because it mitigates the impact of such costs on Peoples Gas' S.C. No. 2 which has already been allocated a portion of the rate increase for S.C. Nos. 1N and it is based on cost causation. The assertion that there are errors on Exhibits VG 2.3-PGL and VG-2.3-NSG is simply incorrect.

The uncollectible expenses reflected in the referenced exhibits are recovered based on rate class specific historical write-offs, consistent with the approach utilized in Mr. Amen's ECOSS and by Mr. Luth to allocate total uncollectible expense in his ECOSS. Luth, Tr. at 1460:1-21; NS-PGL Luth Cross Ex. 9. Additionally, the Utilities proposed that final credits to transportation customers be based on the gas charge revenues and the gas cost related uncollectible expenses for sales customers as approved by the Commission in this proceeding, rather than any credit based on present rate total gas charge revenues which would inappropriately include a credit arising from transportation customers' own gas charge revenues as reflected in Mr. Luth's methodology. Although Ms. Grace and Mr. Luth both proposed to adjust customers' distribution rates for gas cost related uncollectible expense if Rider UBA is not approved, Mr. Luth mischaracterizes Ms. Grace's proposal to support his proposal for Account No. 904 expenses. Although, Mr. Amen correctly demonstrated that Account No. 904 expenses is a customer related cost, the Companies have elected at this time to not recover these customer

related costs through the customer charge in their gradualism approach of not recovering all customer costs through the customer charge. Grace Sur., NS-PGL Ex. VG-3.0 REV, 13:270-277. Therefore, the determination to recover gas cost related bad debt through the distribution charge is warranted and reasonable.

The Utilities have also established the necessity for a different rate treatment for sales and transportation customers if Rider VBA or Rider WNA is implemented without approval of Rider UBA. Gas cost related uncollectible expense under such circumstances should be made on a per customer, rather than on a per distribution therm basis. Grace Sur., NS-PGL Ex. VG-3.0REV,16:344-17:357.

Commission Analysis and Conclusion

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.

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 method employed by the Utilities and Staff do not differ substantially. While the Utilities believe that their method is simpler than that proposed by Mr. Luth., 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. The Commission therefore finds that the method for allocating gas cost related uncollectibles expense is by Staff is reasonable. However, the method should be supplemented by the corrections proposed by the Utilities.

C. Service Classification Rate Design

1. Uncontested Issues

a. North Shore Service Classification No. 4

North Shore

The Company proposed to change the title of this service classification from "Contract Service" to "Contract Service to Prevent Bypass" so it is more descriptive, allow contract terms in excess of five years for this service classification and make minor editorial changes to the tariff language. Grace Dir., NS Ex. VG-1.0 3REV, 23:498-502.

Commission Analysis and Conclusion

The Commission finds the proposal to change the name of S.C. No. 4 to Contract Service to Prevent Bypass is reasonable and is accepted.

b. North Shore Service Classification No. 5

North Shore

The Company's proposal is to set S.C. No. 5 at cost. Therefore, the monthly customer charge was set at \$43.00. The monthly demand charge was set at 10.414 cents per therm and the distribution charge at 1.875 cents per therm. Grace Dir., NS Ex. VG-1.0 2REV, 23:505-508. Based on his ECOSS, Staff witness Luth recommended that the Company's proposed monthly customer charge be reduced by 65 cents per month resulting in a monthly customer charge of \$42.35. Luth Dir., Staff Ex. 7.0, 24:472-475. The Company accepts Mr. Luth's proposed adjustment as long as it is supported by the ECOSS approved in this proceeding.

Commission Analysis and Conclusion

The Commission finds the proposal to set S.C. No. 5 at cost to be reasonable and the rates shall be set in accordance with the revenue requirement set forth in this Order.

c. Peoples Gas Service Classification No. 5

Peoples Gas

The Company's sole proposal is to make minor editorial changes to the tariff language of SC No. 5. Grace Dir., PGL Ex. VG-1.0 REV, 26:578-579. There has been no other proposal by Staff or by any party to this proceeding.

Commission Analysis and Conclusion

The minor editorial changes proposed by the Company is acceptable.

d. North Shore Service Classification No. 6

North Shore

The Company's sole proposal is to make minor editorial changes to the tariff language of SC No. 6. Grace Dir., NS Ex. VG-1.0 3REV, 24:515-516. There has been no other proposal by Staff or by any party to this proceeding.

Commission Analysis and Conclusion

The minor editorial changes proposed by the Company is acceptable.

e. Peoples Gas Service Classification No. 6

Peoples Gas

The Company's proposed changes are to set SC No. 6 at its embedded cost of service and to eliminate the distinction between heating and non-heating customers. The monthly customer charge was set at \$90.00 or 80% of cost. The monthly demand charge was set at cost, 70.956

cents per therm, and the distribution charge at 14.878 cents per therm. Grace Dir., PGL Ex. VG-1.0 REV, 26:584-27:587; Grace Reb., NS-PGL Ex. VG-2.0, 47:1045-48:1063. Staff witness Luth proposed to set S.C. No. 6 at cost although he did not make any specific rate proposals. Grace Sur., NS-PGL Ex VG-3.0, 27:568-572.

Commission Analysis and Conclusion

The Company's proposal to set S.C. No. 6 at cost and to eliminate the heating and non-heating distinction among S.C. No. 6 customers is reasonable and is accepted by the Commission. The rates shall be set in accordance with the revenue requirement set forth in this Order.

f. Peoples Gas Service Classification No. 8

Peoples Gas

The Company proposes to increase charges under SC No. 8 to reflect its embedded cost of service. The monthly customer charge was set at \$140.00 and the distribution charge was set at 5.022 cents per therm. Grace Dir., PGL Ex. VG-1.0 REV, 27:601-605. Staff witness Luth proposed to set S.C. No. 8 at cost although he did not make any specific rate proposals. Grace Sur., NS-PGL Ex. VG-3.0 REV, 27:568-572.

Commission Analysis and Conclusion

The Company's proposal to set S.C. No. 8 at cost is reasonable and is accepted by the Commission. The rates shall be set in accordance with the revenue requirement set forth in this Order.

2. Contested Issues

a. Peoples Gas Service Classification Nos. 1N and 1H

Peoples Gas/North Shore

The issues pertaining to Service Classification Nos. 1N and 1H apply equally to Peoples Gas and North Shore. Therefore, the following discussion applies to both Companies. As was discussed in Section VIII(B)(2)(c) hereof, the Utilities have appropriately demonstrated a basis for bifurcating former Service Classification No. 1 into two service classifications, S.C. No. 1N and S.C. No. 1H. In that earlier section, the Utilities have addressed the reasons the bifurcation proposal is sound. In this section, the Utilities will discuss the specific S.C. No. 1N and S.C. No. 1H charges proposed by other parties, as well as certain S.C. No. 1N and S.C. No. 1H implementation proposals made by Mr. Luth.

As discussed earlier in this Section IX, North Shore has proposed to set its S.C. Nos. 1N and 1H at cost while Peoples Gas has proposed to apply the EPEC methodology to allocate costs to S.C. Nos. 1N and 1H. The Utilities propose to establish the S.C. No. 1N charges for Peoples Gas and North Shore at \$11.25 and \$10.50, respectively. For Peoples Gas, the total monthly embedded fixed costs per customer, with Rider UBA, is \$18.14 and the total monthly allocated cost per customer with Rider UBA, derived by applying the EPEC method, is \$14.99. While the

proposed \$11.25 Peoples Gas charge represents 64% of embedded customer costs and 62% of total embedded fixed costs, by applying the EPEC method and only a portion of allocated customer costs, the increase has been limited to \$2.25 per month in the interest of gradualism. Moving the charge to total allocated fixed cost would require an additional increase of \$3.74 per month, while moving the charge to total embedded fixed cost would require an additional increase of \$6.89 per month.

For North Shore, the total monthly embedded fixed cost per customer with Rider UBA is \$16.18. The proposed \$10.50 charge represents 70% of embedded customer costs and 65% of total embedded fixed costs, North Shore has limited the increase to \$2.00 per month in the interest of gradualism. Moving the charge to total embedded fixed cost would require an increase of an additional \$5.68 per month. Grace Dir., PGL Ex. VG-1.0 REV, 12:249-263; NS Ex. VG-1.0 2REV, 10:208-217.

Peoples Gas is proposing to increase the monthly customer charge for S.C. No. 1H from \$9.00 to \$19.00 and North Shore would increase S.C. No. 1H from \$8.50 to \$16.00. The total embedded fixed cost per customer with Rider UBA is \$36.27 and the total monthly allocated fixed cost per customer, derived by applying the EPEC method, is \$33.80. While the proposed \$19.00 charge represents 71% of embedded costs and 52% of total embedded fixed costs, by applying the EPEC method and only a portion of allocated customer costs, Peoples Gas has limited the increase to \$10.00 per month in the interest of gradualism.

Moving the charge to total allocated fixed costs would require an additional increase of \$14.80 per month, while moving the charge to a total embedded fixed cost would require an additional increase of \$17.27 per month. If properly aligned, such charges would be recovered entirely through a fixed monthly charge. However, in the interest of rate design continuity, Peoples Gas is proposing to recover all demand costs as well as remaining customer costs through the distribution charge.

Similarly, the total embedded fixed cost per customer for North Shore is \$29.28. While the proposed \$16.00 charge represents 55% of total embedded fixed costs and 79% of embedded customer costs, North Shore has limited the increase to \$7.50 per month in the interest of gradualism. Moving the charge to total embedded fixed cost would require an increase of an additional \$13.28 per month. If properly aligned, such charges would be entirely recovered through a fixed charge such as the customer charge or a demand charge. However, in the interest of rate design continuity, North Shore is proposing to recover demand costs as well as remaining customer costs through the distribution charge. Grace Dir., PGL Ex. VG-1.0 REV, 13:285-14:302; NS Ex. VG-1.0 3REV, 11:239-12:253.

Mr. Glahn proposes that S.C. No. 1N not be bifurcated and that Peoples Gas decrease its customer charge to \$10.50, while retaining the distribution charge in Peoples Gas' currently applicable declining block rate structure. Mr. Glahn's proposed customer charge represents a slight increase in the customer charge from \$9.00 to \$10.50. Mr. Glahn's S.C. No. 1 proposal is arbitrary and he offers no analysis or justification for it, except casually comparing it to the customer charges of other Utilities. Mr. Glahn has not performed a cost study for the Utilities nor has he provided any analysis of the other utilities rate designs, costs underlying their rates, or any reasoned discussion of how they have been developed or how they specifically compare with

Peoples Gas' rates or why such a comparison is relevant. In short, Mr. Glahn's proposal amounts to little more than a "seat of the pants" analysis and should be treated accordingly.

Mr. Glahn's proposal for North Shore's S.C. No. 1 charge is similarly flawed. He proposes no bifurcation of North Shore's S.C. No. 1 charge, establishing it at its current level of \$8.50. He offers no analysis to support his customer charge proposal, and he makes no attempt to address the North Shore customer charge in relation to the other components of North Shore's rates, such as the distribution charge. Mr. Glahn's North Shore proposal is at best, superficial and incomplete. In any case, it must be rejected.

Mr. Luth proposes that Peoples Gas slightly increase its proposed S.C. No. 1N in customer charge from \$11.50 to \$12.00. The Company would not be opposed to this charge as long as any change in the distribution charge is reasonable. He also proposes that the increase in the S.C. No. 1N in customer charge be offset by a decrease in the distribution charge. Mr. Luth also proposes that Peoples Gas' S.C. No. 1H charge be set no higher than the Peoples Gas proposed \$19.00 charge. Mr. Luth makes no additional specific recommendations concerning Peoples Gas' S.C. No. 1H distribution charges other than to say that they should not be reduced as long as overall costs are not recovered by rates. As to North Shore, Mr. Luth does not propose any changes to North Shore's S.C. No. 1N. 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 the Utilities' 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.

Other Parties

Peoples Gas/North Shore Response

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 customers⁴. While Mr. Luth made a vague reference to a volume based bifurcation model, he offered no reasoning or data to 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.

As Ms. Grace has pointed out, the Utilities have proposed rates and rate designs that incorporate many of the theoretical principles 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 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. AG well knows that no such allegation or implication can be found on the record or otherwise regarding the Utilities' rate design proposals.⁵

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 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 AG must be denied.

City-CUB also advocates unreasonably low customer charges. City-CUB makes several of the same claims as AG that despite all reasoning to the contrary, lower customer charges must be preserved to protect the interests of one group of customers – low and fixed income rate

⁴ Mr. Luth acknowledges the differences in cost with similar costs differences reflected in his own cost study.

⁵ Again, rather than burdening the Commission with a motion to strike, the Utilities could request that this inflammatory suggestion be totally disregarded.

payers.⁶ In the final analysis, City-CUB has offered no more persuasive reasoning in support of Mr. Glahn's proposals and they must still be rejected.⁷

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 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.

Commission Analysis and Conclusion

Upon reviewing the evidence in respect of the issue of whether to implement a bifurcation between S.C. No. 1N and 1H, the Commission concludes that the Utilities' proposal is reasonable and based upon a method that is appropriate and supported by the record. The Commission acknowledges that Staff witness Luth has presented proposals for implementing an election procedure and to differentiate the proposed S.C. No. 1H and S.C. No. 1N customers based on small volume vs. larger volume instead of the Utilities' heating vs. non-heating distinction. While Mr. Luth's proposals are interesting, the Commission believes that his proposal to establish bifurcation along volumetric lines is somewhat vague and not sufficiently detailed to permit appropriate evaluation. Mr. Luth's customer election proposal is likewise problematic. The Commission agrees with the Utilities that the introduction of annual elections for service classifications would result in unwarranted complexity. In addition, the Commission is unable to ascertain precisely what benefits would be obtained by customers switching service

⁶ City-CUB 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

⁷ 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.

classifications without a reasonable and appropriate reason for doing so. The Commission believes that the Utilities bifurcation proposal along heating vs non-heating lines is a far more reasonable basis for the bifurcation since the Utilities have established that they maintain data and procedures which permit them to appropriately classify customer accounts accurately.

The Commission also believes that the embedded cost of service study is the most appropriate means of assigning costs to S.C. No. 1N and 1H and the application of the EPEC method in conjunction with the cost study generates rates that properly reflect a greater recovery of fixed costs as the Commission has suggested is appropriate. The Commission finds that the approach proposed by Mr. Glahn is inconsistent with the Commission's preference for relatively greater fixed cost recovery. Mr. Glahn's proposal would generate rates using the filed revenue requirement that are substantially below those proposed by the Utilities. The Commission finds it difficult to evaluate the propriety of Mr. Glahn's proposal because it is unaccompanied by sufficient analysis or justification in the form of a cost study or some other measure. While the Commission is sensitive to the need to balance social goals with other objectives in its rate design determination, the Commission does not believe the parties opposing the Utilities' proposal have demonstrated that the Utilities have not employed broad objectives, including social goals, in the S.C. No. 1N and S.C. No. 1H proposals. In any event, the Commission believes that the Utility proposals, on balance, represents the most reasoned approach to establishing just and reasonable rates for small residential heating and non-heating customers.

Alternative

The Commission believes however that while the customer election procedure proposed by Mr. Luth is overly complex and not supported by the Utilities, the Utility rate design proposals can nevertheless be accommodated without the heating and non-heating bifurcation. The Commission directs the Utilities to collapse the proposed S.C. No. 1N and S.C. No. 1 H classifications into a single S.C. No. 1 classification, such as the one that presently exists for their systems. Mr. Luth has agreed that in the event of such a rejoining of S.C. No. 1 that a reasonable approach to determining the customer charge is the one proposed by Ms. Grace for a non-bifurcated service classification. This approach is reflected in NSPGL Ex. VG-3.0; 11-12:226-247. Therefore, the Utilities shall not bifurcate S.C. No. 1 and shall set the customer charge based on the approach proposed by the Utilities which reflects the Commission's decision on Rider UBA. The remaining charges shall be set to meet the revenue requirement for S.C. No. 1 based on the methodology proposed by the Utilities.

b. North Shore Service Classification Nos. 1N and 1H

Please see discussion in Section IX(C)(2)(a) of this Order.

c. Peoples Gas Service Classification No. 2

Peoples Gas

Peoples Gas proposes to increase the monthly customer charge for S.C. No. 2 customers and to move the charges for meter classes one and two closer to embedded cost for each individual meter class, instead of considering an average of the embedded customer cost for all S.C. No. 2 customers. The proposed monthly customer charges would increase from \$15.00 to

\$21.00 for Meter Class 1 and increase from \$22.00 to \$60.00 for Meter Class 2. These charges are supported by the ECOSS. Peoples Gas is also proposing to maintain the three declining block distribution charge for SC No. 2 and to allocate 23%, 61% and 16% of the remaining customer, demand and commodity costs to the front, middle and end blocks, respectively.

The front block charge has been increased to 35.441 cents, the middle charge has been increased to 13.669 cents per therm and the end block has been decreased to 7.199 cent per therm. The proposed S.C. No. 2 charges exclude the gas cost portion of uncollectible expenses, which would be recovered through Rider UBA. Without Rider UBA, the proposed customer charges would remain the same but the front, middle and end block charges would be 37.695 cents per therm, 14.5339 cents per therm and 7.655 cents per therm, respectively. Grace Dir., PGL Ex. VG-1.0 REV, 22:480-23:511.

Other Parties

Peoples Gas' Response

Mr. Glahn proposes to increase Peoples Gas' Meter Class 1 customer charge to \$27.00 so that it "matches" a charge for one utility and "falls in the midst" of certain other utilities. On the other hand, Mr. Glahn selectively avoids any comparison for Meter Class 2 as Peoples Gas' proposed rate at \$60.00 is less than the \$70.00 and \$90.00 rates charged by those certain other utilities. Mr. Glahn's proposals are based on arbitrary, inapt comparisons and not on sound ratemaking principles.

North Shore proposes to increase the monthly customer charge for S.C. No. 2 customers and move the charges for Meter Classes 1 and 2 closer to the embedded cost for each individual meter class, instead of considering an average of the embedded customer cost for all S.C. No. 2 customers. The proposed monthly customer charges would increase from \$15.00 to \$17.00 for Meter Class 1 and from \$22.00 to \$60.00 for Meter Class 2. The proposed customer charges are less than the embedded fixed cost for each meter type and are supported by the ECOSS. North Shore is proposing to also maintain the three declining block S.C. No. 2 distribution charge and allocate 25%, 55% and 20% of the remaining customer demand and commodity cost to the front, middle and end blocks respectively. The front block increases to 23.248 cents per therm, the middle block decreases to 8.716 cents per therm and the end block decreases to 2.769 cents per therm.

The proposed S.C. No. 2 rates for North Shore do not include the gas cost portion of uncollectible expense which is recovered through Rider UBA. Without Rider UBA the monthly customer for North Shore would mostly remain the same and the front, middle and end block charges would be 24.175 cents per therm, 9.064 cents per therm and 2.879 cents per therm, respectively. Grace Dir., NS Ex. VG-1.0 3REV, 19:408-20:438.

Mr. Glahn proposes that the North Shore S.C. No. 2 customer charges not be increased. He offers no reasoned analysis or other detail to support his proposal. Thus, Mr. Glahn's S.C. No. 2 recommendations are arbitrary and without merit. Although Peoples Gas does not agree with Mr. Luth's undefined rate increase methodology for S.C. No. 2, Mr. Luth's rate design proposals are consistent with those proposed by Peoples Gas.

As to North Shore's S.C. No. 2, however, there appears to be some divergence of opinion between Mr. Luth and North Shore. Mr. Luth proposes to change North Shore's S.C. No. 2 demand device and transportation administrative charges. Those charges, are cost based and rider specific for North Shore's proposed transportation Riders AGG, SST and P, irrespective of a customer's service classification. It is not appropriate to adjust rider specific charges simply to meet a particular service classification's revenue requirement. If North Shore's S.C. No. 2 needs to be adjusted to meet its revenue requirement, it would be more appropriate to adjust charges that are applicable to the service classification, rather than a charge designated in several riders that applies to several service classifications. Grace Sur., NS-PGL Ex. VG-3.0 REV, 23:499-508.

Commission Analysis and Conclusion

The Commission is inclined to find that the Company's proposal is the most reasonable means to design the S.C. No. 2 rates. Mr. Glahn's proposal is so lacking in analysis that it is unclear why he would propose to not increase the S.C. No. 2 customer charges in a general rate increase framework. Mr. Luth's proposal to change the S.C. No. 2 demand device and administrative charges does not appear to be based on any cost basis or other persuasive reasoning and must likewise be rejected.

d. North Shore Service Classification No. 2

Please see Section IX(C)(2)(c) of this Initial Brief.

e. North Shore Service Classification No. 3

North Shore

North Shore's current S.C. No. 3 is a cost based rate that serves large volume, high load factor customers. Present rates include a monthly two block demand structure which is set at 5,000 therms and over 5,000 therms. North Shore proposes to increase the front block to 10,000 therms to better reflect the higher monthly demand volumes that are representative of this service classification. The minimum, average and maximum monthly demand volumes for this service classification are 19,000 therms, 26,000 therms and 34,000 therms, respectively.

The current demand block structure, which current data show is set too low, results in 19% of demand volumes falling within the first block and 81% of demand volumes falling in the end block. This does not allow North Shore to recover its demand costs through a reasonable rate design that accurately reflects the customer profile. To remedy this, at least partially, and to allow a more balanced cost recovery, the Company proposes to increase the front block to 10,000 therms. This would result in 38% of demand volumes falling within the first block and 62% of demand volumes falling within the second block. The revenue from S.C. No. 3 will be set at embedded cost as determined in the ECOSS. This is consistent with the rate treatment in North Shore's last rate case. Grace Dir., NS Ex. VG-1.0 3REV, 21:456-22:471.

The demand charge will be set at 80% of cost, with 50% being recovered through the front demand block. That results in about 75% of the total S.C. No. 3 revenue requirement being

recovered through the demand charges. The front block (0-10,000 therms) demand charge will be set at 49.065 cents per demand therm and the end block (over 10,000 therms) demand charge will be set at 30.574 cents per demand therm. The monthly customer charge will be set at cost and will be \$705.00. The monthly standby service charge will be set at 11 cents per therm of standby demand with the remaining revenue being recovered through the distribution charge, which will be set at .262 cents per therm. *Id.*, at 472-480.

Other Parties

[Insert]

North Shore Response

Mr. Luth proposes to allocate \$236,527 more costs to S.C. No. 3 based on his use of the Average and Peak methodology over the amount that North Shore proposed. While he does not propose any changes to the customer charge, he is proposing to recover 23.1% of the S.C. No. 3 demand costs through the distribution charge resulting in an increase in the proposed S.C. No. 3 distribution charge to 0.46 cents per therm. Applying this proposed rate to the S.C. No. 3 distribution volumes results in distribution charge revenue of \$85,246, which is only \$36,693 higher than what North Shore proposed. A comparison of this amount to Mr. Luth's additional \$236,527 of proposed S.C. No. 3 costs, results in an under-recovery of S.C. No. 3 costs of approximately \$199,800.

Mr. Luth failed to account for these additional costs in his revenue adjustments for S.C. No. 3. In addition, North Shore proposed to recover only 80% of demand related costs in the demand charge, with the remaining demand and commodity costs being recovered through the standby service charge and the distribution charge. This proposal is very similar to what Mr. Luth is proposing, but Mr. Luth used a different cost allocation methodology. As Mr. Luth agrees with North Shore's proposed customer charge and derives a demand charge which is similar to that proposed by North Shore, the distribution charge would need to be adjusted to appropriately recover the revenue requirement arising from his ECOSS. The charges would also need to be adjusted to reflect revenues arising from the standby service charge that was corrected. NS-PGL Ex. VG-2.10. Based on that correction, the standby service charge would be reduced from 11 cents per therm to 7 cents per therm. Even with the proposed changes, all charges would need to be supported by the final ECOSS arising from this proceeding. Grace Reb., NS-PGL Ex. VG-2.0, 46:1019-47:1042.

Mr. Luth does not address North Shore's S.C. No. 3 in his Rebuttal Testimony although Staff Ex. 19.0, Schedule 19.1-NS accompanying that testimony reflects different demand and distribution charges than those proposed in his Direct Testimony and in data responses. Otherwise, Mr. Luth's customer charge proposal approximates that proposed by North Shore. Grace Sur., NS-PGL Ex. VG-3.0 REV, 26:560-565. Given the lack of clarity attending Mr. Luth's proposals for North Shore's S.C. No. 3 charges, the Commission should adopt the Company's proposal which appears not to differ greatly from Mr. Luth's recommendations.

Commission Analysis and Conclusion

The Commission accepts the Company's S.C. No. 3 proposal. It is unclear whether there is an objection to it or a counter proposal.

f. Peoples Gas Service Classification No. 4

Peoples Gas

The Company's current S.C. No. 3 is a cost based rate that was designed to serve large volume, low load factor customers. The Company's current S.C. No. 4 is a cost based rate that was designed to serve large volume, high load factor customers. In the Company's last rate case the average load factors for S.C. No. 3 and S.C. No. 4 were 42% and 75%, respectively. Currently, these load factors are 37% and 51%, respectively. As the difference in average load factors has significantly narrowed between the two service classifications, it is no longer necessary to provide service under two separate large volume service classifications. Combining these two service classifications under S.C. No. 4, Large Volume Demand Service, is also supported by the Company's ECOSS which demonstrates that on a per demand therm basis, there is very little difference in costs.

The revenue from S.C. No. 4 will be set at embedded cost for S.C. Nos. 3 and 4 combined as determined in the ECOSS. This is consistent with the rate treatment in the Company's last rate case. The monthly customer charge will be set at cost and will be \$565.00. The demand charge will be set at 80% of cost, with 70% being recovered through the front demand block. That results in about 59% of the total S.C. No. 4 revenue requirement being recovered through the demand charges. The monthly standby service charge will be set at 24 cents per therm of standby demand with the remaining revenue being recovered through the distribution charge, which will be set at 1.211 cents per therm. The front block (0-7,500 therms) demand charge is 50.609 cents per demand therm and the end block (over 7,500 therms) demand charge is 40.163 cents per demand therm.

Currently, S.C. No. 3 customers are not required to have a daily demand measurement device to determine billing demand although S.C. No. 4 customers are required to have such a device. As the Company is proposing to increase the amount of the revenue requirement being recovered through the demand charge, these customers will be required to have a daily demand device to determine billing demand. This should have a minimal impact on most S.C. No. 3 customers as about 90% of the current customers already have such devices installed. For those customers who do not have a daily demand device installed, until such device can be installed, the billing demand will be calculated using the same methodology currently used to make such a determination for transportation customers.

Other Parties

[Insert]

Peoples Gas' Response

The sales customers' standby demand will be the same as their billing demand and the Rider SST customers' standby demand will be their selected standby demand. The Company

would propose the same charges as those with Rider UBA. Grace Dir., PGL Ex. VG-1.0 REV, 24:530-26:565. Using his ECOSS, Mr. Luth's proposal results in only 33% of demand costs being recovered through the demand charge. This shifts 60% of demand cost recovery through a volumetric distribution charge with 7% of demand costs being recovered through the standby service charge. Mr. Luth's ECOSS shows volumetric commodity costs for Peoples Gas' S.C. No. 4 of \$804,826 while his proposal results in recovery of \$9.1 million or 1,119% over the amount that should be recovered on a volumetric basis. Mr. Luth expresses concern about Peoples Gas' increased demand charge for former S.C. No. 3 customers but overlooks the impact that his higher distribution charge would have on all customers. Mr. Luth's proposal would more than triple the distribution charge for current Peoples Gas' S.C. No. 4 customers.

Mr. Luth's proposed rate designs, which are not based on sound ratemaking principals, would be uneconomical to customers in this service classification and may induce some to switch to S.C. No. 2 or bypass Peoples Gas' system. Conversely, Peoples Gas' proposals are reasonable and based on sound ratemaking principals.

Commission Analysis and Conclusion

The Commission accepts the Company's proposal to combine the two service classifications and the Commission has been presented with no persuasive evidence why the two service classifications should remain separate in view of the convergence of load factors that has been demonstrated.

g. Peoples Gas Service Classification No. 7

Peoples Gas

The Company's current S.C. No. 7, Contract Service, is available to any customer for whom bypass of the Company's gas distribution system is economically feasible and practical. Grace Dir., PGL Ex. VG-1.0REF, 27:593-595. The Company proposes to change the description of this services classification from "Contract Service" to "Contract Service to Prevent Bypass" to make it more descriptive and allow for a longer term contract in response to customer requests. *Id.* at 27:595-598. No parties have contested those issues.

Other Parties

Peoples Gas' Response

Mr. Glahn's proposal to allocate costs to S.C. No. 7 is flawed for several reasons, however. First, is it rooted in his assumption that Peoples Gas "assumes that the costs to service this group of customers has not increased since 1995." Glahn Dir., GCI Ex. 3.0 REV, 13:16-17. Peoples Gas' present tariff limits contract terms for customers served under this service classification to five years. As a result contracts which may have been in place since Peoples Gas' last rate case over eleven years ago have been renegotiated based on the proper cost considerations. Peoples Gas' allocation has been performed against the backdrop of the circumstances presently in place in respect of the contracts, *i.e.*, data which has changed since 1996. Mr. Glahn has not explained how any rate increase he might impute into rate design could

be factored into the binding contracts that are currently in effect and that may expire up to five years from the effective date of Peoples Gas' increase. Accordingly, Witness Glahn's proposed allocations for S.C. No. 7 should be rejected by the Commission and Peoples Gas' proposed changes should be approved.

Commission Analysis and Conclusion

As the Commission indicated in its discussion of the allocation of the rate increase, S.C. No. 7 is a classification under which all rates are contractually based and individually negotiated. The service classification has been renamed to clarify that it is intended to address bypass concerns and there is no reason to penalize the Company by attributing costs to the service which the utility might not be able to recover. The Commission therefore finds Mr. Glahn's proposal to be unwarranted and possibly harmful.

D. Tariffs – Other Tariff Issues

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. However, Staff has objected to language in some of the Tariffs, of which all but two of the objections have been resolved.

1. Rider 2, Factor TS

Other Parties

[Insert]

North Shore / Peoples Gas Response

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 Dan 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.

Commission Analysis and Conclusion

The Commission accepts the Companies' proposal to revise Rider 2 to reflect the applicability and renaming of applicable transportation riders and eliminate Factors TS , Transition Surcharge and refund or recover any dollars awaiting recovery or refund through NCGC, Non-Commodity Gas Charge.

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

Other Parties
[Insert]

North Shore / Peoples Gas Response

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 REV, 32:709-711. The Commission has approved an increased charge of \$25.00 for Mid American Energy in Docket No. 99-0534. *Id.* at 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.” *Re Mid American Energy Company*, 2000 WL 3444650 (Ill.C.C. July 11, 2000) (Docket No. 99-0534).

In these proceedings, as in *Mid American Energy*, revenue from the Utilities’ charge will offset the increase in base rates in this proceeding. Grace Dir., PGL Ex. VG-1.0, 32:711-718. Staff Witness Cheri Harden is supportive of the Companies’ proposal. Harden Dir., Staff Ex. 9.0, 11:226. Witness 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, 15:354-363; Glahn Dir., GCI Ex. 3.0 REV, 35:2-8. This Commission was clear when it approved a similar increase in the *Mid American Order* (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.

Commission Analysis and Conclusion

The Commission finds the arguments of GCI witness Glahn unpersuasive. This Commission has previously approved an increased charge of \$25.00 for *Mid American Energy* in Docket No. 99-0534. *Id.* at 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.” *Re Mid American Energy Company*, 2000 WL 3444650 (Ill.C.C. July 11, 2000) (Docket No. 99-0534). The Commission is aware of no reason to abandon the logic that led to that result.

3. Rider 4, Extension of Mains

Other Parties
[Insert]

North Shore / Peoples Gas Response

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 REV, 36:795-802. Staff Witness Cheri 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. No. 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.

Commission Analysis and Conclusion

The Commission accepts the proposed changes to Rider 4 clarifying language and addressing certain practices and customer preferences. We acknowledge Staff's agreement to the changes based on the removal of language regarding "return".

4. Rider 5, Gas Service Pipe

Other Parties

[Insert]

North Shore / Peoples Gas Response

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 REV, 36:804-37:811. As with Rider 4, Staff Witness Cheri Harden disagreed with the language of Rider 5 regarding "return" and recommended the language not be approved by the Commission. Harden Reb., Staff Ex. No. 21, 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-3.0 REV, 29:627-628. No other parties addressed this matter and therefore, it is not contested.

Commission Analysis and Conclusion

The Commission accepts the proposed changes to Rider 5 clarifying language and addressing certain practices and customer preferences. We acknowledge Staff's agreement to the changes based on the removal of language regarding "return".

5. Rider 8, Heating Value of Gas Supplied

Other Parties

[Insert]

North Shore / Peoples Gas Response

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 REV, 37:821-824. Staff Witness 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., ICC Staff Ex. No. 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 REV, 37:821-826. Therefore, it is appropriate that filings be made only when there is such a change.

Commission Analysis and Conclusion

We agree with the concern expressed by Staff Witness Harden regarding the assurance that the Utilities are reviewing heating value factors on an ongoing basis. However the Commission is of the opinion that the greatest concern is when the heating value factor changes. Therefore, the Commission finds that the Companies' proposal regarding Rider 8 and orders that a filing is supported by the evidence and is approved with the changes proposed by the Companies in Rider 8.

6. Elimination of Riders 13, 14, 15, CCA and LCP

Other Parties

[Insert]

North Shore / Peoples Gas Response

Staff Witness Harden agrees with the Companies proposed elimination of Riders 13, 14, 15, CCA, and LCP. Harden Dir., Staff Ex. No. 9.0, 18:392-397, 19:409-415, 19:425-426, 20:445-447, 21:461-463. No other parties addressed these matters, which leaves them uncontested.

Commission Analysis and Conclusion

Staff agrees with the Companies regarding the elimination of Riders 13, 14, CCA and LCP. The Commission finds the elimination of the Riders 13, 14, 15, CCA and LCP to be supported by the evidence in the record.

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

Other Parties
[Insert]

North Shore / Peoples Gas Response

Staff Witness Harden is in agreement with the changes to Riders 1, 3, 10 and 11, and no other parties addressed these matters.

Commission Analysis and Conclusion

Staff agrees with the Companies regarding the changes to Riders 1, 3, 10, and 11. The Commission finds the changes to Riders 1, 3, 10, and 11 to be supported by the evidence in the record.

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

Other Parties
[Insert]

Peoples Gas' Response

Peoples Gas proposes to revise Rider 1 to clarify language and to incorporate the language from Riders 15 and CCA, which are being eliminated. Rider 15 provides for taxes on the use of compressed natural gas while Rider CCA provides for charges arising from the Energy Assistance Act of 1989 and the Renewable Energy, Energy Efficiency and Coal Resources Development Law of 1997. Grace Dir., PGL Ex. VG-1.0 REV, 35:763-767. Staff Witness Harden concurs with the Companies' modifications. Harden Dir. Staff Ex. No. 9.0, 23:496-504.

Commission Analysis and Conclusion

Staff agrees with Peoples Gas' proposal to revise Rider 1 to clarify language and to incorporate the language from Riders 15 and CCA which are being eliminated. The Commission finds the changes to Rider 1 to be supported by the evidence in the record.

b. **Rider 3, Budget Plan of Payment**

Other Parties
[Insert]

North Shore/Peoples Gas Response

The Companies propose to revise the language of Rider 3 to make it more consistent with the Companies' current budget plan. Grace Dir., PGL Ex. VG-1.0 REV, 36:789-793; Grace Dir. NS Ex. VG-1.0 3REV, 32:696-701. Staff witness Ms. Harden finds the changes acceptable. Harden Dir., Staff Ex. No. 9.0, 26:556-558.

Commission Analysis and Conclusion

Staff agrees with the Companies proposal to revise the language of Rider 3 to make it more consistent to the Companies current budget plan. Commission finds the changes to Rider 3 to be supported by the evidence in the record.

c. Rider 10, Controlled Attachment Plan

Other Parties

[Insert]

North Shore/Peoples Gas Response

The Companies propose to revise Rider 10 to reflect the applicability of the rider based on the elimination and renaming of transportation riders and to make the language more understandable. Grace Dir., PGL Ex. VG-1.0 REV, 34:740-742 and 38:833-835. Staff agrees with the proposed changes in Rider 10. Harden Dir., Staff Ex. No. 9.0, 31:692-32:695.

Commission Analysis and Conclusion

Staff agrees with the Companies proposal to revise Rider 10 to reflect the applicability of the rider based on the elimination and renaming of transportation riders. The Commission finds the changes to Rider 10 to be supported by the evidence in the record.

d. Rider 11, Adjustment of Incremental Costs of Environmental Activities

The Companies made minor editorial changes and revised Rider 11, as required by the Commission's order in Docket No. 06-0540 to reflect the Companies' change to a calendar year for its fiscal year. Grace Dir., PGL Ex. VG-1.0 REV, 34:745-747 and 38:838-840. Staff agrees with the proposed changes in Rider 11. Harden Dir., Staff Ex. No. 9.0, 32:710-33:715.

Commission Analysis and Conclusion

The Commission acknowledges the submitted revisions to Rider 11 based on its prior order in Docket No. 06-0540.

X. TRANSPORTATION ISSUES

A. Overview

North Shore / Peoples Gas

Peoples Gas and North Shore each proposed substantial revisions to its existing transportation tariffs. Zack Dir., PGL Ex. TZ-1.0REV; NS Ex. TZ-1.0. Each Utility's existing transportation tariffs consist of two separate programs – a large volume transportation program and a small volume transportation program.

Each Utility first made gas transportation service available to large volume customers in the mid-1980's. The details of each Utility's large volume transportation were largely put in place in each Utility's last rate case – Docket No. 95-0031 for North Shore and Docket No. 95-0032 for Peoples Gas. Each Utility's existing large volume transportation program is set forth in Riders FST (Full Standby Transportation), SST (Selected Standby Transportation), LST (Large Volume Selected Standby Transportation), TB (Transportation Balancing) and P (Pooling). The first three riders describe the customer's service level. Rider FST is a full standby service available to all customers except those served under S.C. No. 1. Rider SST is a partial standby service available to S.C. Nos. 2 and 8 customers on Peoples Gas and to S.C. No. 2 customers on North Shore. Rider LST is a partial standby service that is very similar to Rider SST, available to S.C. Nos. 3 and 4 customers on Peoples Gas and to S.C. No. 3 customers on North Shore. Customers served under Rider LST for each Utility have fully unbundled base rates, and Rider LST reflects this rate design. Rider TB is the required balancing service used by Rider LST customers who elect 0% standby service. Rider P is the aggregation or pooling service that the suppliers who sell gas to large volume transportation customers purchase. Each large volume transportation customer receives an Allowable Bank ("AB") that allows it to balance differences between the quantities of gas actually delivered by its gas supplier to the Utilities and the quantities of gas actually consumed by that customer.

Each Utility's current small volume transportation program is set forth in Rider SVT (Small Volume Transportation) and Rider AGG (Aggregation). The small volume transportation customer takes service under Rider SVT, and the supplier who sells gas to that customer purchases an aggregation service under Rider AGG. Peoples Gas' small volume program originally was introduced in 1997 as a pilot program for small volume General Service customers. In 2002, Peoples Gas' small volume transportation program was made permanent and expanded to include Small Residential Service customers and North Shore implemented a substantially identical small volume program. Under each Utility's small volume transportation program, the small volume supplier receives a proportionate share of each Utility's storage capabilities based on the requirements of that supplier's customers and on how the Utility uses its storage capabilities, subject to the monthly storage injection and withdrawal parameters provided by each Utility to these suppliers in the Required Daily Delivery Quantity that each Utility calculates and subject to the 10% daily tolerance that each Utility provides to these suppliers for daily deliveries. In addition (and unlike the large volume program), each Utility takes responsibility for forecasting small volume delivery requirements correctly.

In these proceedings, Peoples Gas originally proposed the expansion of Rider SVT (and renaming it CFY), the elimination of Rider FST, changes to Rider SST, the merging of Rider LST into Rider SST, and changes to Rider TB and Rider P. Zack Dir., PGL Ex. TZ-1.0REV, 1:17-20. North Shore originally proposed the expansion of Rider SVT (and renaming it CFY), the elimination of Rider FST, changes to Rider SST, the merging of Rider LST into Rider SST, changes to Rider P and the elimination of Rider TB. Zack Dir., NS Ex. TZ-1.0, 1:18-21. However, the underlying reason presented by each Utility for its proposal was the same: the storage and standby rights of each Utility's transportation customers need to be shaped to be consistent with each Utility's individual gas supply portfolio, and each Utility needs to have an annual mechanism to adjust those rights as its individual gas supply portfolio changes. Zack Dir., PGL Ex. TZ 1.0REV, 3:49-52; NS Ex. TZ-1.0, 3:50-53.

Other Parties

[Insert]

B. Uncontested Issues

1. Demand Diversity Factor

North Shore / Peoples Gas

Under its current rates Peoples Gas' demand Diversity Factor is 0.50. Zack Dir., PGL Ex. TZ-1.0REV, 21:482-484. Peoples Gas has proposed to set its Diversity Factor to 0.87. Zack Dir., PGL Ex. TZ-1.0REV, 21:486-22:489. Neither any intervenor nor Staff has filed any evidence in opposition to this proposal. Under its current rates North Shore's demand Diversity Factor is 0.50. Zack Dir., NS Ex. TZ-1.0, 20:456-457. North Shore's has proposed to set its Diversity Factor to 0.75. Zack Dir., NS Ex. TZ-1.0, 20:459-462. Neither any intervenor nor Staff has filed any evidence or otherwise submitted any statement in opposition to this proposal.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that North Shore's proposed demand Diversity Factor of 0.75 is supported by the evidence and is approved. The Commission finds that Peoples Gas' proposed demand Diversity Factor of 0.87 is supported by the evidence and is approved.

2. Daily Demand Measurement Device Charge

North Shore / Peoples Gas

Peoples Gas proposed to change its Daily Demand Measurement Device Charge from a range of three charges, depending on the type of meter, to a single charge of \$28.00 per month. Zack Dir., PGL Ex. TZ-1.0REV, 48:1100-1102; PGL Ex. TZ-1.17. Neither any intervenor nor Staff has filed any evidence in opposition to this proposal. North Shore proposed to change its Daily Demand Measurement Device Charge from a range of three charges, depending on the type of meter, to a single charge of \$34.00 per month. Zack Dir., NS Ex. TZ-1.0, 46:1047-1049; NS Ex. TZ-1.17. Neither any intervenor nor Staff has filed any evidence in opposition to this proposal.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that North Shore's Daily Demand Measurement Device Charge of \$34.00 per month is supported by the evidence and is approved. The Commission finds that

Peoples Gas' Daily Demand Measurement Device Charge of \$28.00 per month is supported by the evidence and is approved.

3. Elimination of Rider TB (NS)

North Shore

North Shore proposed to eliminate Rider TB. Zack Dir., NS Ex. TZ-1.0, 17:515. Neither any intervenor nor Staff has filed any evidence in opposition to this proposal.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that North Shore's proposed elimination of Rider TB is supported by the evidence and is approved.

4. Revised Calculation of Average Monthly Index Price

North Shore / Peoples Gas

North Shore proposed to change its calculation of the Average Monthly Index Price ("AMIP") from an average of weekly indices to an average of daily indices. Zack Dir., NS TZ-1.0, 45:1018-1023. Peoples Gas proposed to make the same change to its calculation of the AMIP. Zack Dir., PGL TZ-1.0REV, 46:1051-1056. Neither any intervenor nor Staff has filed any evidence in opposition to this proposal.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that each Utility's proposed change to its calculation of AMIP is supported by the evidence and is approved.

5. Administrative Charges for Rider SST and Rider P

North Shore / Peoples Gas

Peoples Gas proposed that the monthly administrative charge for Rider SST be reduced to \$23.00 and that the monthly administrative charge for Rider P be set at \$18.00. Zack Dir., PGL Ex. TZ-1.6, Page 1 of 2. North Shore proposed that the monthly administrative charge for Rider SST be reduced to \$21.00 and that the monthly administrative charge for Rider P be set at \$13.00. Zack Dir., NS Ex. TZ-1.6, Page 1 of 2.

Other Parties

Vanguard objected to each Utility's proposal to round the charges and complained that these rates should be set only to recover costs incurred. Vanguard Ex. 1.0, 18:394-405; Vanguard Ex. 2.0, 18:394-405.

North Shore / Peoples Gas' Response

In rebuttal Mr. Zack testified that the Utilities did not object to setting the Rider SST charge at \$23.16 for Peoples Gas and \$21.48 for North Shore and the Rider P charge at \$17.55 for Peoples Gas and \$12.61 for North Shore. Zack Reb., NS-PGL Ex. TZ-2.0, 45:993-996. No other party expressed any opposition to the revised administrative charges reflected in Mr. Zack's rebuttal testimony. Furthermore, in light of the Utilities' proposals to retain a form of Rider FST, the Utilities recalculated these monthly administrative charges, and the recalculated charges would yield a Rider SST charge of \$11.24 for Peoples Gas and a Rider SST charge of \$8.94 for North Shore, and a Rider P charge of \$8.36 for Peoples Gas and a Rider P charge of \$4.95 for North Shore. Zack Sur., NS-PGL Ex. TZ-3.0, 6:117-118; NS-PGL Ex. TZ-3.1.

Commission Analysis and Conclusion

The Commission finds that North Shore's proposed Rider SST charge of \$8.94 and its proposed Rider P of charge \$4.95 are supported by the evidence and are approved. The Commission finds that Peoples Gas' proposed Rider SST charge of \$11.24 and its proposed Rider P of charge \$8.36 are supported by the evidence and are approved.

6. Elimination of 120 Day Meter Read Requirement for CFY Enrollment

North Shore / Peoples Gas

Consistent with the requirements of Rider SVT, the Utilities' practice has been to hold any CFY customer enrollment request if there is not an actual reading of a customer's meter in over 120 days.

Other Parties

RGS proposed that this requirement be eliminated. RGS Ex. 1.0, 42.

North Shore / Peoples Gas Response

The Utilities have accepted RGS' position on this issue, so it no longer is a contested issue. Zack Reb., NS-PGL Ex. TZ-2.0, 58:1295-1299.

Commission Analysis and Conclusion

The Commission finds that proposed elimination of the 120 day meter read requirement for CFY enrollment is uncontested and reasonable, and therefore approves it.

7. Meter Reading

The Utilities note that this is not an issue affected transportation customers, but rather sales customers. It was inadvertently left in this portion of the parties' joint outline, and should probably be moved to an appropriate location for the actual order. It probably should be in a separate section with the materials in X.(E)(7).

Staff initially raised a concern with the number of consecutively unread meters, but Staff, in rebuttal testimony, expressed general satisfaction with Peoples Gas' responses in testimony, and suggested that Peoples Gas should provide quarterly updates (within 30 days after the end of each quarter), to the Director of the Energy Division and the Director of the Consumer Services Division of Staff, summarizing the number of consecutively unread meters without a reading for more than six months, or three months in the case of ERTed meters. Lounsberry Reb., Staff Ex. 23.0, 20:382- 23:443, 25:485 - 26:499. Peoples Gas agreed to provide these reports. Doerk Sur., PGL/NS Ex. ED-3.0, 3:64 - 4:69. No party opposed the agreement to provide the reports.

8. Automatic Meter Reading

Other Parties

Vanguard and Multiut argued that the availability of automatic meter reading ("AMR") addressed the Utilities' concerns about meter reading for Rider FST customers. Vanguard Ex. 1.0, 11-12; Vanguard Ex. 2.0, 11-12; Multiut Ex. 1.0, 6.

North Shore / Peoples Gas Response

The Utilities responded that AMR did not alleviate the larger issue of the need to better align customer usage with daily injection and withdrawal rights. NS-PGL Ex. TZ-2.0, 6:123-130. However, in light of the Utilities' withdrawal of their proposal to eliminate Rider FST and, in their proposed form of Rider FST, to retain the absence of a daily metering requirement, *infra*, Section X.C.1., this argument is moot.

Commission Analysis and Conclusion

The Commission finds that the issue raised by Vanguard and Multiut regarding automatic meter reading is moot in light of North Shore's and Peoples Gas' withdrawal of their proposal to eliminate Rider FST.

9. Billing Demand Determination

Other Parties

CNE-Gas proposed that the Utilities be compelled to change their method of determining a customer's Billing Demand from being the customer's highest daily demand in terms from December to February of the most recent 12 month period to the arithmetic average of the customer's highest five daily demands in terms from December to February of the most recent 12 month period. CNE-Gas Ex. 1.0, 25:551-554.

North Shore / Peoples Gas Response

The Utilities originally opposed CNE-Gas' proposal. Zack Reb., NS-PGL Ex. TZ-2.0, 46:1006-1011. However, they also indicated they could accept a compromise revision to the Billing Demand definition based on certain alternate tariff language proposed by CNE-Gas. Zack Reb., NS-PGL Ex. TZ-2.0, 46:1011-47:1032. In rebuttal testimony CNE-Gas advised that it was willing to accept the Utilities' compromise language on this issue. CNE-Gas Ex. 2.0, 34:716-720. Neither any other intervenor nor Staff has filed any testimony in connection with the proper determination of Billing Demand.

Commission Analysis and Conclusion

The Commission finds that North Shores' and Peoples Gas' proposed revised definition of Billing Demand is uncontested and reasonable, and therefore approves it.

10. Imbalance Trading

North Shore / Peoples Gas

In its original filing Peoples Gas proposed to expand the circumstances under which imbalance trades would be allowed. Zack Dir., PGL Ex. TZ-1.0REV, 49:1108-1123. It proposed that trades be allowed for any movement of gas to or from a customer's Allowable Bank ("AB") for any reason, as long as (1) they net to zero within Peoples Gas' system; (2) they cannot reduce bank balances below minimum bank requirements or increase them above maximum bank requirements; (3) they are confirmed by both parties; (4) they are done via PEGASysTM; and (5) they may not eliminate daily balance penalties. North Shore originally proposed identical permissible imbalance trading provisions. Zack Dir., NS Ex. TZ-1.0, 46:1052-47:1070. In rebuttal, Mr. Zack clarified that an additional condition of a permissible trade was that a customer could not trade gas in excess of the amount of its imbalance. Zack Reb., NS-PGL Ex. TZ-2.0, 65:1447-1453.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that each of North Shores' and Peoples Gas' proposals to expand the circumstances under which imbalance trades would be allowed are uncontested and reasonable, and the Commission approves them.

C. Large Volume Transportation Program

1. Rider FST

North Shore / Peoples Gas

Each Utility originally proposed to eliminate its Rider FST, with existing FST customers to take transportation service, at their election, either under a more inclusive Rider CFY or under a modified Rider SST, or to take retail sales service. Zack Dir., PGL Ex. TZ-1.0REV; NS Ex. TZ-1.0. The reasons for their proposals to eliminate Rider FST are that the actual operation of the program results in inefficient meter reading procedures and more importantly it expends assets beyond those reasonably appropriate for the provision of the service. Zack Dir., PGL Ex. TZ 1.0, 33:745-747; NS Ex. TZ 1.0, 31:719-721.

Other Parties

[Insert]

North Shore / Peoples Gas Response

In response to the criticisms of their original proposals, the Utilities proposed to retain an alternative form of Rider FST. Zack Sur., NS-PGL TZ-3.0, 4:85-87. Under their revised proposal, a customer's daily nominations under Rider FST would be capped at the customer's average daily use in the comparable month in the prior year plus 0.67% (20% divided by 30) of the customer's Allowable Bank ("AB"), and with the customer being obligated to operate within the framework of the Utilities' end of season restrictions on storage balances that it proposed for Rider SST. Zack Sur., NS-PGL TZ-3.0, 5:104-111. The Utilities stated that their revised proposals regarding Riders FST and SST are based on suggestions made by Vanguard (Vanguard Ex. 2.0, 9:200-203), and Commission Staff (ICC Staff Ex. 24.0, 12:229-237) to address the concerns of transportation customers while addressing the most problematic aspects of the Utilities' current transportation programs. By establishing a cap on deliveries and using the prior year's historical usage as the starting point for the calculation, there is no need for daily metering under proposed Rider FST. Except for these changes to the operational requirements, proposed Rider FST generally retains the existing features of current Rider FST. Proposed Rider FST also includes an updated Diversity Factor based on the study used to support the Rider SST Diversity Factor, several editorial changes for consistency with Rider SST, incorporation of the expanded imbalance trading rights and, based on the study used to support other administrative charges, revised administrative charges of \$8.94 for Peoples Gas and \$11.24 for North Shore. According to the Utilities, while the compromise provisions proposed by the Utilities regarding the revision of Riders FST and SST are not the first choice of any party to this case, they represent a reasonable resolution of the relevant issues. The Utilities' revised Rider FST is set forth in NS-PGL Ex. TZ-3.2.

Commission Analysis and Conclusion

The Commission recognizes that the Utilities and transportation customers have conflicting goals in that the Utilities desire to control customer gas delivery for the purposes of

managing their distribution systems while the customers desire to maximize their ability to change delivery and consumption to minimize their costs. Both goals are reasonable and legitimate, and the Commission's task is to harmonize them to the extent possible. Each Utility's proposed Rider FST would cap, each day, a customer's daily nomination to the customer's average daily use in the comparable month of the prior year plus 0.67% (20% divided by 30) of the customer's AB. The Commission clarifies that "comparable month" means the same month from the prior year, *i.e.*, the October limitations will be based on estimated usage from the prior October. The Utilities' revised Rider FST, including the end of season AB requirements, strikes a reasonable balance between the Utilities' desire to control gas delivery into their systems with the Rider FST customer's desire to maintain some flexibility in connection with their gas deliveries. The Commission finds that the proposed administrative charges of \$11.24 for Peoples Gas and \$8.94 for North Shore are supported by the evidence and are approved. Therefore, the Commission approves each of North Shore's and Peoples Gas' proposed revised Rider FST.

2. Rider SST

North Shore / Peoples Gas

North Shore and Peoples Gas originally proposed substantial revisions to their Riders SST. They each originally proposed that a maximum amount of gas that a Rider SST customer could withdraw from its AB on any day be established through customer-specific factors on an annual basis. They also each originally proposed that a maximum amount of gas that a Rider SST customer could inject into its AB on any day also be established through customer-specific factors on an annual basis. These maximums were designed to mirror the rights available to each Utility from its storage assets.

Other Parties

[Insert]

North Shore / Peoples Gas' Response

In response to criticisms the Utilities modified their proposed changes to Rider SST. Zack Sur., NS-PGL TZ-3.0, 9-10:180-217. In lieu of their original proposals for daily injection and withdrawal limits for SST customers, the Utilities proposed revised Riders SST that would limit a customer's monthly injections to 20% of AB converted to a daily injection limit, but they would not place additional daily limits on a customer's withdrawals from AB from limits currently in effect. Unlike the proposed limit for Rider FST, the fact that Rider SST's consumption is daily metered allows the Utilities to set a daily injection limit rather than tie the limit to an estimate of prior year's usage. The Utilities state that this will allow Rider SST customers to adjust for expected changes in consumption and still make AB injections. *Id.*, at 185-195. The revised Riders SST would have new daily and monthly injection provisions as proposed in the form of nomination limits similar to that reflected in each Utility's proposed revised Rider FST while retaining the existing daily and monthly withdrawal provisions. The Utilities' revised Rider SST is set forth in NS-PGL Ex. TZ-3.3REV.

Commission Analysis and Conclusion

The Commission agrees with the Utilities' stated goal of tailoring its transportation customers' rights to the rights that are available to the Utilities in the assets and services supporting the transportation programs. However, the Utilities' original proposals to revise their Riders SST could have deprived Rider SST customers of too much of the flexibility which a transportation customer should have in arranging its withdrawals from and its injections into its AB. Moreover, the Commission finds that the approach proposed for Rider FST, which the Commission approved, is one that should apply to Rider SST. Specifically, the Utilities should set a daily nomination limitation, rather than a daily AB injection limitation. The Rider SST customer's daily nomination would be capped at the customer's daily use in the same month in the prior year plus 0.67% (20% divided by 30) of the customer's AB. With that change and other tariff changes that may be needed to revise the Utilities' proposal and implement a nomination cap, the Commission finds that the Utilities' revised proposed Rider SST strikes a reasonable balance between the Utilities' ability to manage their storage resources on an aggregate basis and the Rider SST customer's desire to have substantial flexibility in injecting gas into and withdrawing gas from its AB. Therefore, the Commission approves each of North Shore's and Peoples Gas' proposed revised Rider SST.

3. Daily Metering Requirements

North Shore / Peoples Gas

The Utilities proposed to maintain their requirement that Rider SST customers would be required to have their gas consumption metered on a daily basis and Rider CFY customers need not have daily metering. Consequently, under the Utilities' original proposal to eliminate Riders FST, customers moving to Rider SST would be required to have daily metering, but FST customers moving to Rider CFY would not be required to have daily metering. Zack Dir., PGL Ex. TZ-1.0REV, 35:797-799; NS Ex. TZ-1.0, 34:769-773.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities' revised proposals regarding Riders FST and SST, discussed under X.D.1., and X.D.2., above, essentially moot this issue. Customers currently being served under Rider FST will be able to continue to receive service under that Rider without having to have their consumption metered daily. Customers currently being served under Rider SST would continue to be required to have their consumption metered daily, and any customer electing to be served under Rider SST in the future would be required to have its consumption metered daily.

Commission Analysis and Conclusion

The Commission finds that the issues previously raised regarding daily metering requirements are moot in light of the Utilities' revised proposals regarding Riders FST and SST. The Utilities no longer are proposing any changes to their existing tariffs regarding daily

metering requirements, and no party has argued that their existing tariffs regarding daily metering requirements are unjust or unreasonable.

4. Injection, Withdrawal and Cycling Requirements

North Shore / Peoples Gas

Each Utility has proposed that its large volume transportation customers be required to satisfy storage cycling requirements regardless of whether they receive service under Rider FST or under Rider SST. North Shore proposes that each large volume transportation customer have its AB at least 85% full on November 30 and its AB no more than 24% full on March 31. Peoples Gas proposes that each large volume transportation customer have its AB at least 70% full on November 30 and its AB no more than 35% full on March 31. Each Utility presented six years of operating data to support its discrete proposed storage cycling requirements. NS Ex. TZ-1.1; PGL Ex. TZ-1.1. The Utilities stated that in each case the data show that the proposed storage cycling requirements for transportation customers are more favorable to those customers than the storage cycling requirements within which the applicable utility must operate with respect to its leased storage services.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities' disagree with CNE-Gas's claim that both Utilities should have common cycling targets, because the Utilities are separate utilities with separate distribution systems, assets and discrete storage rights. They also reject CNE-Gas' claims that the Utilities should not be able to impose both fall and spring storage targets on transportation customers because they each operate its system within the bounds of those fall and spring storage targets. The Utilities reject the claims of CNE-Gas and IIEC that the Utilities don't need to impose cycling requirements on their transportation customers because the Utilities have been able to properly cycle their storage gas in the past without imposing these requirements. According to the Utilities, they have been able to do so only because they have imposed delivery restrictions on their transportation customers from time to time, and CNE-Gas and Multiut also complain of such delivery restrictions. Finally, the Utilities also reject CNE-Gas' argument that if the cycling requirements are imposed, they should have a period of time, such as thirty days, over which to measure compliance. With such a window, the Utilities state that they could be in the position of actively dumping supply to reach their own storage target levels while the transportation customers are adding to their AB. The converse also could apply. The Utilities say they can't be in the position of being prevented from meeting cycling targets because the transportation customers have chosen to take supply actions that are contrary to those being taken by the Utilities.

Commission Analysis and Conclusion

The Commission finds that each Utility's end of season storage inventory requirements for its transportation customers are reasonable and are therefore accepted. Staff's position that

transportation customers and their marketers should be encouraged to cycle their storage is persuasive. The Commission also finds that each Utility should have requirements based on its own system. The evidence introduced by each Utility clearly establishes that the end of season storage inventory requirements it proposes for its transportation customers are more generous than those which the Utility itself must satisfy, and that these requirements will assist each Utility in maintaining the operational integrity of its system.

5. Unbundled Storage Bank (“USB”)

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities oppose being compelled to offer the proposed USB. NS-PGL Ex. TZ-2.0, NS-PGL Ex. TZ-3.0. They maintain that the USB proposal would provide USB customers with daily injection and withdrawal rights vastly exceeding the capabilities of Manlove, which would necessarily mean that the Utilities’ sales customers would subsidize the USB service. The Utilities also maintain that the USB proposal would make it more difficult for the Utilities to manage their systems for the benefit of all their customers. They also maintain that the USB advocates’ revised USB proposal ignores the fact that the Utilities are separate from each other, have different gas storage rights and are separately regulated by the Commission. Moreover, North Shore does not own a storage field, *i.e.*, it does not have a base rate storage asset to unbundle.

Commission Analysis and Conclusion

The Commission believes that no customer class should receive a disproportionate share of the economic benefits of a lower cost storage asset in relation to other customer classes served by a utility, nor should transportation customers receive rights that are disproportionate to the assets and services supporting those rights. The Commission finds that the USB proposal would grant USB subscribers a disproportionate share of Peoples Gas’ lowest cost storage resource. The Commission rejects the proposed USB service.

6. Rider P-Pooling

a. Pool size limits

North Shore / Peoples Gas Response

In response to supplier requests, the Utilities each proposed to increase the maximum pool size under Rider P from 150 to 200 accounts. Zack Dir., NS Ex. TZ-1.0, 43:986-987; PGL Ex. TZ-1.0REV, 45:1020-1021.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities believe that they can accommodate a pool size increase from 150 to 200 accounts without much difficulty, but believe that they will encounter billing and administrative problems if pool sizes are increased substantially or if the pool size limit is eliminated entirely. The Utilities note that Nicor Gas Company, a substantially larger gas distribution system than either of the Utilities, currently has a 150 account pool size limit.

Commission Analysis and Conclusion

The Commission finds that the Utilities' proposals to increase their pool size limit from 150 to 200 accounts reflects a reasonable compromise between suppliers' desires for substantially larger sized pools and the Utilities' concerns about billing and administrative problems. The Commission approves the Utilities' proposals to increase their Rider P pool size limit from 150 to 200 accounts and the Commission rejects the countervailing proposals of CNE-Gas and Vanguard.

b. "Super-pooling"

CNE Proposal

[Insert]

North Shore / Peoples Gas Response

The Utilities initially opposed being compelled to accept any form of super-pooling, based on their concerns about being able to implement it without significant billing system programming and without establishing a separate billing entity. NS-PGL Ex. TZ-2.0. However, upon further consideration, the Utilities agreed that they could accept a form of super-pooling if it were limited to being used solely for the purpose of determining if the supplier meets the two storage cycling requirements and if individual stand alone (non-pooled) customers were excluded. NS-PGL Ex. TZ-3.0. The Utilities explained that it is inappropriate to include stand alone customers in a super pool because those customers are free to purchase gas from different suppliers and, therefore, could not be linked to a specific supplier's super pool. The Utilities note that the form of super-pooling they are proposing to accept is identical to that in effect on the Nicor Gas system.

Commission Analysis and Conclusion

The Commission finds that Utilities' counterproposal to implement a limited form of super-pooling reflects a reasonable balance between the interests of the Utilities' sales customers and their transportation customers, and that it reflects a reasonable resolution of the merits between the competing interests of all parties. Accordingly the Commission approves the Utilities' counterproposal to implement super-pooling solely for the purpose of determining if the supplier meets the two storage cycling requirements and by excluding individual stand-alone (non-pooled) customers.

c. **Permitting Customers with Different Selected Standby Percentages (SSP) to Be in the Same Pool.**

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities opposed being compelled to accept pools containing customers with different SSPs in the same pool because extensive programming changes would be required to their billing systems to implement this requirement. NS-PGL Ex. TZ 2.0. However, if the Utilities were ordered to do so, they have indicated that the pool standby percentage would be calculated in the following manner: (1) a pool's MDQ would be the summation of the underlying customer (contract) MDQs, and (2) a pool's SSP would be the weighted average of its customers' (contract) SSPs. Id., at 874-887.

Commission Analysis and Conclusion

The Commission finds that CNE-Gas' proposal to permit customers with different elected stand by percentages to be in the same supplier pool would cause the Utilities to undertake extensive programming changes to their billing systems. Therefore, the Commission rejects CNE-Gas' proposal.

7. **Operational Issues**

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

North Shore / Peoples Gas

The Utilities originally proposed that each day a customer or supplier with more than one contract or pool be permitted, on an intra-day basis, to re-allocate deliveries between or among its contracts or pools. NS Ex. TZ-1.0; PGL Ex. TZ-1.0REV. The purpose behind the Utilities' proposals was to permit suppliers to reallocate gas among their contracts to permit them to offset any potential gas deficiencies and avoid penalties.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities do not accept CNE's proposal to require the Utilities to accept amended gas nominations during the course of a day. NS-PGL Ex. TZ-2.0. Intra-day nominations are industry standard as far as interstate pipelines are concerned, but they certainly are not standard as far as local gas distribution companies are concerned. Zack, Tr. at 781:8-10. The Utilities state that they must manage the entire utility system; they are the supplier of last resort and must meet demand with supply, despite a dynamic demand profile, on a real time basis. The Utilities argued that the imposition of an obligation on the Utilities to accept intraday nominations from transporters would be a serious problem because the Utilities must scramble to match supply

with consumption, and then have to adjust their supply to do so. They can't be in the position of, e.g., trying to shed supply during a warm winter day while marketers are trying to increase their supply because prices are low because it is a warm winter day.

Utilities also point out that, in judging tariffs, one needs to review the rules of the utility as a whole, because each tariff has numerous provisions, and some provisions may be favorable in one area and other provisions may be less favorable. An example is contained in CNE-Gas' own testimony, in which are listed a number of utilities that purportedly allow intraday nominations. CNE-Gas Ex. 1.0. However, when the actual tariff of one of these utilities was examined, it was revealed that the utility requires suppliers to exactly match deliveries and consumption on a daily basis, making intraday nominations more appropriate. CNE-Gas Witness Rozumialski, Tr. at 781:2-7.

Commission Analysis and Conclusion

The Commission finds that the Utilities' proposals to allow intraday allocations are reasonable and will provide benefits to the Utilities' transportation customers without causing the Utilities or their sales customers to suffer any detriments. Therefore the Commission approves the Utilities' proposals to allow intraday allocations.

The Commission finds that the adoption of CNE-Gas' proposal to compel the Utilities to permit intraday nominations by gas transporters could make it substantially more difficult for the Utilities to balance their systems on a real time basis to the potential detriment of sales and other transportation customers. The Commission is not persuaded that the Utilities' current nomination procedures from transporters are unjust or unreasonable. Therefore, the Commission rejects CNE-Gas' proposal to compel the Utilities to accept intraday nominations from gas transporters.

b. Delivery Restrictions

Other Parties

[Insert]

North Shore / Peoples Gas' Response

The Utilities impose delivery restrictions only when customer deliveries are disproportionate to customer consumption requirements. NS-PGL Ex. TZ-2.0, NS-PGL Ex. TZ-3.0. The Utilities recognize that the imposition of delivery restrictions on transportation customers can be problematic, but they do need to balance their systems on a daily basis and these restrictions are needed from time to time to enable them to do so. The Utilities do negotiate with suppliers on a case by case basis to enable a supplier to effect a limited time reduction in delivered volumes with a guarantee that deliveries on subsequent days could return to the supplier's required baseload volume even while a delivery restriction remains in effect. The Utilities do not believe there would be any real benefit in trying to spell out a procedure in their tariffs under which negotiated exceptions to the imposition of delivery restrictions could be requested.

Commission Analysis and Conclusion

The Commission finds that there are times when the Utilities must impose delivery restrictions to balance their systems. The Commission therefore rejects Multiut's proposal that the Utilities be prevented from imposing delivery restrictions on transportation customers.

The Commission also finds that CNE-Gas has failed to show that there would be any substantial benefit to require to Utilities to spell out a procedure in their tariffs under which negotiated exceptions to the imposition of delivery restrictions could be requested, provided such exceptions are permitted on a non-discriminatory basis. Therefore, the Commission rejects CNE-Gas' proposal to compel the Utilities to spell out a procedure in their tariffs under which negotiated exceptions to the imposition of delivery restrictions could be requested by transportation customer suppliers.

8. Other Large Volume Transportation Issues

a. Accounting for Trading and Storage Activity

Other Parties

[Insert]

North Shore / Peoples Gas Response

No other Peoples Gas or North Shore customer or supplier has claimed that Peoples Gas or North Shore improperly handles accounting for imbalance traded gas and storage transfer gas by its transportation customers. Peoples Gas and North Shore each maintains that its accounting for its customer trading and storage activity is appropriate in light of some practical administrative issues, NS-PGL Ex. TZ-2.0, and that neither Vanguard nor any of Peoples Gas' or North Shore's other transportation customers or suppliers are harmed by its accounting methodology. Peoples Gas and North Shore also note that Vanguard admitted, both in response to discovery and in Vanguard's own rebuttal testimony (Vanguard Ex. 3.0, 6:119-121, for each of Peoples Gas and North Shore), that no one has been harmed by the Utilities' accounting for imbalance traded gas and storage transfer gas.

Commission Analysis and Conclusion

The Commission finds that there is no evidence in the record of any harm to any of Peoples Gas' or North Shore's customers as a result of the Utilities' accounting practices concerning imbalance traded gas and storage transfer gas. The Commission also finds that Vanguard has not presented a specific proposal for this issue that the Commission can adopt. Therefore, the Commission declines to order any change in Peoples Gas' or North Shore's accounting for imbalance traded gas and storage transfer gas.

b. Excess Bank and Critical Surplus Day Unauthorized Overrun Charges

Other Parties

[Insert]

North Shore / Peoples Gas' Response

Each of North Shore and Peoples Gas propose that it continue to be authorized to charge its existing Excess Bank Charge of \$0.10 per therm and its Critical Surplus Day Unauthorized Overrun Charge of \$6.00 per therm. NS Ex. TZ-1.6; PGL Ex. TZ-1.6. Multiut Ex. 1.0, 8. Neither of these charges is new. The Utilities state that the Excess Bank Charge is imposed only to deter customers from delivering gas to the Utilities in quantities in excess of the customer's total AB capacity. Tr. at 546:6-17. The Utilities argue that, absent the Excess Bank Charge, and subject only to the Utilities' end of season storage cycling requirements, a customer would be able to have inventory substantially in excess of its AB without incurring any financial penalty for doing so. The Utilities state that the Critical Surplus Day Unauthorized Overrun Charge is assessed only to keep transportation customer supply equal to consumption on days in which there is a critical excess of supply coming into the Utilities' systems.

Commission Analysis and Conclusion

The Commission finds that the Utilities' existing Excess Bank Charge of \$0.10 per therm and their existing Critical Surplus Day Unauthorized Overrun Charge of \$6.00 per therm are reasonable charges designed to provide transportation suppliers with reasonable incentives to avoid delivering gas to the Utilities in excess of the supplier's total AB and to keep the supplier's supply equal to its consumption on days in which there is a critical excess of supply coming into the Utilities' systems. Therefore, the Commission orders that the Utilities continue to be authorized to charge their existing Excess Bank Charge of \$0.10 per therm and their existing Critical Surplus Day Unauthorized Overrun Charge of \$6.00 per therm.

c. Cash-outs Index

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities state that their proposals to sell gas to a customer at 110% of AMIP and to buy gas from a customer at 90% of AMIP to the extent that such customer fails to comply with the Utilities' end of season storage inventory requirements are reasonable incentives designed to influence customers to comply with the Utilities' end of season storage inventory requirements. The economic effect of these proposals can easily be avoided by the customer arranging to fill and deplete its AB in compliance with those requirements at pure market prices. The Utilities also explained that the costs and revenues of these purchases and sales are accounted for in Rider 2, Gas Charge, so there is no financial benefit to the Utilities from this pricing structure.

Commission Analysis and Conclusion

The Commission finds that the Utilities' proposals to (1) sell gas to a transportation customer supplier at 110% of AMIP to the extent that the customer fails to comply with the Utilities' November 30 storage injection requirements and (2) buy gas from a customer at 90% of AMIP to the extent that the customer fails to comply with the Utilities' March 31 storage withdrawal requirements are reasonable, in light of the end of season inventory requirements that

the Commission is approving in these proceedings. The proposals both provide appropriate incentives for suppliers to meet the seasonal targets and protect sales customers from any adverse effects on gas costs caused by the Utilities having to buy or sell gas when suppliers fail to meet their obligations. Therefore, the Commission approves the Utilities' proposed cash-out index pricing provisions.

d. Receipt of Service Classification, Rider, AB, MDQ and SSP Information

Other Parties
[Insert]

North Shore / Peoples Gas' Response

The Utilities are willing to make these data available on their electronic bulletin board system, called PEGASys™. The Utilities initially indicated that they should not be obligated to make the data available on PEGASys™ until the Utilities have accepted and processed the customer enrollment request. In surrebuttal, the Utilities indicated that they would be willing to make these data available on PEGASys™ at the time of customer enrollment, subject to Commission approval of the making of this information available. After considering the arguments made in Vanguard's Initial Brief, the Utilities are also willing to make these data available on PEGASys™ as long as the requesting supplier signs the Utilities' "Customer Usage Data Contract" evidencing its agreement to obtain the customer's approval before it request the customer's consumption history, and as long as the data are made available only in connection with the Utilities' large volume transportation programs. NS-PGL Ex. TZ-3.0.

Commission Analysis and Conclusion

The Commission finds that the Utilities' making available on PEGASys™ to large volume transportation suppliers Service Classification, Rider, AB, MDQ and SSP customer information should reasonably facilitate a customer's enrollment with a large transportation supplier without having an adverse effect on that customer or on the Utilities, as long as the supplier obtains the prior approval of that customer to obtain its consumption history. Access to customer data involving small volume transportation programs raises different concerns, and they are dealt within the small volume transportation program section of this Order. The Commission approves Vanguard's proposal on this issue but limits its approval to the data of large volume customers.

D. Small Volume Transportation Program (Choices For YouSM or "CFY")

1. Storage Rights and Aggregation Rights

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

Other Parties
[Insert]

North Shore / Peoples Gas' Response

The Utilities oppose RGS' proposal. The Utilities maintain that granting CFY suppliers additional storage flexibility would be providing them rights in excess of what they are paying for. The Utilities explain that the gas consumption of CFY customers is not metered daily, so there is no way to verify that CFY supplier injections and withdrawals are within the daily parameters that RGS proposes to establish. RGS' proposal uses peak day (maximum) capabilities, even though these maximum capabilities do not exist with respect to the Utilities' storage assets and rights throughout the applicable injection or withdrawal season. NS-PGL Ex. TZ-2.0. The Utilities point out that CFY suppliers do have the ability to inject gas into storage in the summer and withdraw it in the winter. They also point out that the Utilities provide balancing services for CFY suppliers and their customers. Under CFY, the Utilities explain that they propose no changes to the current program under which the Utilities set a Required Daily Delivery Quantity ("RDDQ") and, therefore, the Utilities assume the risk associated with customer use forecasts and the attendant balancing requirements. The RDDQ takes storage use and the effect of weather into account. The Utilities also cite the existence of the 10% daily and proposed 5% monthly delivery tolerances as evidence of the existence of generous storage and balancing rights for the benefit of CFY customers. NS-PGL Ex. TZ-3.0.

The Utilities oppose RGS' proposed Rider AGG. RGS claims that its proposal is based on tariff provisions currently in effect on the Nicor Gas system. However, there are significant differences. For example, the utilities point out that the "Storage Quantity Target Levels" for the winter months provide substantially wider ranges than those in the Nicor Gas rider. NS-PGL Ex. TZ-3.0.

Similarly, RGS' proposed Rider AGG provides that, to the extent a CFY supplier's aggregation group load increases throughout the winter, storage in place for such customers shall transfer with the customers, and the supplier's November 1 Storage Inventory Level will be modified to reflect such changes. The Utilities argue that, conspicuous by its absence is a corresponding provision in RGS Ex. 2.1 to decrease a supplier's November 1 Storage Inventory Level if the supplier's aggregation load decreases.

Commission Analysis and Conclusion

The Commission finds that RGS' proposed Rider AGG would inappropriately grant CFY suppliers storage flexibility in excess of what they pay for and that the grant of that flexibility would be inequitable to the Utilities' other customers. The Commission finds that it is reasonable for the Utilities to distinguish the storage rights and obligations under its small customer program from its large customer program. The Commission finds that RGS offered no support for the terms and conditions of its proposed Rider AGG as it would apply to the Utilities' systems. Therefore, the Commission declines to order the Utilities to assign to CFY suppliers substantially larger specific daily, monthly, seasonal and annual allocations of storage rights, and the Commission rejects RGS' proposed Rider AGG.

b. Aggregation Balancing Gas Charge (ABGC)

North Shore / Peoples Gas

The Utilities proposed to move the billing of the Aggregation Balancing Gas Charge (“ABGC”) from the CFY supplier to the customer at the account level, in response to request by RGS members and others.

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Commission should reject RGS’ demand to eliminate the ABGC. The Utilities state that they incur costs to provide the storage and daily balancing services that the Utilities provide to CFY customers. NS-PGL Ex. TZ-2.0. Those costs are based on the firm storage and related transportation services that the Utilities purchase to support the balancing services they provide to CFY suppliers. It is appropriate for the Utilities to recover these costs from the customers who obtain the benefits of the services provided by the Utilities as a result of the costs incurred by the Utilities. The Utilities argue that they could provide neither balancing services nor storage accounts for CFY suppliers unless these costs are incurred, and there is no reason why any customer class should get free balancing and storage service from the Utilities.

Commission Analysis and Conclusion

The Commission finds that the Utilities’ proposals to move the billing of the ABGC from the CFY supplier to the customer at the account level is appropriate to eliminate confusion that sometimes arises with CFY customers over the billing of this charge by CFY suppliers, and therefore the Commission approves the Utilities’ proposals. The Commission also finds that CFY suppliers and their customers do receive balancing and storage services from the Utilities, that the ABGC is properly designed to recover the costs of these services, and that the ABGC charges are reasonable. Therefore the Commission rejects RGS’ proposal to eliminate the ABGC.

c. Pipeline Capacity Assignment

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities oppose this alternate proposal on the grounds that it is not feasible. NS-PGL Ex. TZ-2.0, NS-PGL Ex. TZ-3.0. The Utilities cite the administratively active nature of the capacity release process, which involves several steps that must be completed in a short period of time. They also note that RGS’ suggestion that recall rights would protect the Utilities’ operational needs should the CFY supplier not perform is problematic because their exercise of recall rights would be cumbersome. The also noted that RGS cited three gas distributors who do conduct capacity release programs, but none of them operate in Illinois.

Commission Analysis and Conclusion

The Commission found that CFY suppliers receive the storage and balancing rights for which they are paying. Moreover, RGS' proposal to grant CFY suppliers the option to receive an assignment of storage capacity and pipeline capacity would result in significant changes to the Utilities' CFY program and to the relationships between the Utilities and CFY suppliers, CFY customers and the Utilities other customers. The Commission is hesitant to order the Utilities to yield control of this capacity when they are charged with the responsibility of balancing their systems on a daily basis. The Commission finds RGS' proposal to be problematic and therefore rejects it.

d. Customer Migration

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities reject RGS' claim. The Utilities adjust supplier storage rights during the injection season as pool enrollment changes. In addition, the Utilities are proposing a "storage true-up" mechanism that further adjusts storage during the injection season. NS-PGL Ex. TZ 2.0. They do not adjust supplier storage rights for customer migration during the withdrawal season because of the need for the CFY programs to schedule withdrawals in a measured way over the course of winter, with appropriate adjustments for weather. They also note that this benefits a supplier that loses customers during the withdrawal season. Also, winter period customer migration is reflected in the following winter period's storage allocation to the supplier.

Commission Analysis and Conclusion

The Commission finds that the Utilities' existing practices regarding customer migration are reasonable, and the Commission will not compel the Utilities to change them. The Commission finds that the Utilities' proposed storage true-up during the injection season is reasonable, and the Commission approves it.

e. Month End Delivery Tolerance

North Shore / Peoples Gas

The Utilities have proposed to increase the month-end delivery tolerance for CFY suppliers from 2% of Monthly Adjusted Deliveries to 5% of Monthly Adjusted Deliveries. NS Ex. TZ-1.0; PGL Ex. TZ-1.0REV.

Other Parties

[Insert]

Commission Analysis and Conclusion

The Commission finds that it is reasonable that CFY suppliers be required to operate within monthly, as well as daily, delivery parameters, because the Utilities have to operate their systems within similar parameters. The Commission also finds that the Utilities' proposals to increase the month-end delivery tolerance for CFY suppliers from 2% to 5% are reasonable, and the Commission therefore approves them. The Commission rejects RGS' proposal to eliminate the month end delivery tolerance requirement in its entirety, as well as RGS' alternate proposal to increase the tolerance to 10%, which, in light of the 10% daily tolerance, is tantamount to eliminating the requirement.

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

Other Parties

[Insert]

North Shore / Peoples Gas' Response

The Utilities recognize the validity of RGS' claim, and they propose to include a credit from working capital in the CFY customer Aggregation Charge, as is currently the case. The Utilities presented an analyses that resulted in a proposed credit for Peoples Gas of \$2.26 per customer and for North Shore of \$1.48 per customer. The impact of the Peoples Gas credit on the Rider AGG per customer aggregation charge is to create a per customer credit of \$0.83 and for North Shore the result is a reduced charge of \$0.03. NS-PGL Ex. TZ-2.0; NS-PGL Ex. TZ-3.0; NS-PGL Ex. TZ-3.4. However, the Utilities reject RGS' claim that the Utilities' administrative Monthly Aggregation Charge should be eliminated entirely because all administrative charges should be a part of base rates. The Utilities maintain that they need to recover costs associated with CFY program administration, supplier and customer care, and customer education, as well as maintaining and enhancing the systems used to administer the CFY program, including PEGASysTM enhancements, and that it is appropriate for them to recover these costs through the administrative Monthly Aggregation Charge.

Commission Analysis and Conclusion

The Commission finds that the imposition by the Utilities of the Monthly Aggregation Charge, supported by the data submitted by the Utilities in NS Ex. TZ-1.7 and PGL Ex. TZ-1.7, continues to be appropriate, and the Commission approves the charges. The Commission finds that the working capital credits computed by the Utilities and the proposals to apply them to the per customer aggregation charge are reasonable and are approved.

2. Customer Enrollment

a. Customer data issues

Other Parties

[Insert]

North Shore / Peoples Gas Response

In response to the complaints and proposals by RGS, the Utilities have made four proposals regarding customer data.

First, they have proposed to provide customers lists, excluding customers on the Utilities' "do not contact" lists, to CFY suppliers without customer consent but pursuant to a contract with the Utilities. The customer list would include customer names and addresses, and whether the customer is a service classification 1N or 1H customer, but it would not include customer telephone numbers.

Second, the Utilities have proposed to provide, pursuant to a contract, more detailed customer information to CFY suppliers in two tiers. The first tier (Tier 1) would not include any customer information and would not require customer consent. The second tier (Tier 2) would include customer information but would require customer consent. Neither the first tier nor the second tier data would be provided to CFY suppliers for free. Tier 2 information would include name, billing address, premises address, usage, type of meter reading and other reading dates.

Third, if directed to do so by the Commission in these proceedings, the Utilities would provide a customer's payment history to a CFY supplier, if the supplier, among other things, warrants that it has that customer's consent to obtain that customer's payment history from the Commission and indemnifies the Utilities against any claim that the supplier does not have that consent.

Fourth, if directed to do so by the Commission in those proceedings, the Utilities would provide a customer's past due amounts to a CFY supplier if the supplier, among other things, warrants that it has that customer's consent to obtain that customer's past due amounts data from the Utilities and indemnifies the Utilities against any claim that the supplier does not have that consent.

Commission Analysis and Conclusion

The Commission finds that each of the Utilities' four proposals regarding the provision of customer data to CFY suppliers reflect reasonable attempts to balance the competing interests of CFY suppliers in obtaining access to market data, customers maintaining some control over access to their individual data, and the Utilities avoiding getting involved in disputes between CFY suppliers and customers concerning access to customer data. Therefore, the Commission approves each of the Utilities' four proposals, subject to the customer consent requirements discussed below.

b. Evidence of Customer Consent

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities believe that it is appropriate that a CFY supplier be required to obtain a customer's consent before obtaining access to Tier 2 customer – specific information from the Utilities. In the case of Tier 2 information, the Utilities believe that evidence of that customer consent could consist of the CFY supplier having access to a specific piece of customer information, such as an account number, that would allow the CFY supplier to gain access to the specific customer's Tier 2 data in the Utilities' data base.

The Utilities believe that a higher threshold for evidence of customer consent may well be appropriate with respect to a CFY supplier receiving a customer's payment history and a customer's past due amounts from the Utilities. From a conceptual standpoint, Staff's position that "explicit customer approval" be required before a CFY supplier gains access to a customer's payment history and its past due amounts makes sense. However, the Utilities believe it is incumbent upon the Commission to define what would constitute the "explicit customer approval" that a CFY supplier must obtain before it obtains access to these two sensitive forms of customer data. The Utilities are in the position of honest brokers trying to satisfy the competing interests of CFY suppliers, Staff and potential CFY customers. The Utilities should not become subject to disputes between CFY suppliers and potential CFY customers concerning access to these two more sensitive forms of customer information. The Utilities argue that CFY suppliers should indemnify the Utilities against any claim of a potential CFY customer that the customer did not consent to the disclosure of that customer's payment history and past due payment data to that particular CFY supplier.

Commission Analysis and Conclusion

The Commission finds that the Utilities' proposal to evidence customer consent to the disclosure of Tier 2 customer specific data to a CFY supplier by the CFY supplier having access to a specific piece of customer information, such as an account number, is reasonable, and the Commission approves it.

The Commission finds that the concerns of the Utilities and the Staff about the disclosure of customer payment history and customer past due payment data are valid. The Commission also finds it reasonable that the Utilities be able to require a CFY supplier to indemnify them against any CFY customer damage claim arising out of the Utilities' provision of their CFY customer's payment history and past due payment data as a condition precedent to the Utilities providing that customer's payment data and past due payment data to the CFY supplier, and the Commission approves the Utilities' proposed tariff language with respect to indemnity and other matters as reasonable. In addition, the Commission finds that it should define what constitutes "explicit customer consent" to the disclosure of customer payment history and customer past due payment data. The Commission defines "explicit customer consent" as follows:

"Explicit customer consent" can be evidenced in either of the following ways, and the supplier need not use the same method for all customers. Any supplier wishing to obtain a customer's past due amount and payment history information from the Utilities must, by written contract with the Utilities, warrant and represent that it has the necessary customer consent and agree to produce proof of

consent upon request, whether to resolve a dispute or for audit purposes. Under either approach, the consent must specifically be for payment history and past due amounts and general statements of agency rights are not sufficient. Explicit customer consent means: (1) the supplier obtains independent third party verification by recorded telephone conversation that the customer has consented to the disclosure of customer payment history and past due amounts; or (2) the supplier has a written contract with the customer that specifically authorizes the supplier to receive the customer's payment history and past due amounts. The supplier requesting that the Utilities provide this information must provide all applicable form contracts to the Utilities and warrant and represent that each customer for which it seeks information have signed such a contract. The Utilities need not receive the signed contract for each customer, but the supplier must provide any contract on request.

c. Minimum Stay Requirement

North Shore / Peoples Gas

The Utilities initially proposed to continue to require a CFY customer returning to utility sales service and not selecting another CFY supplier within 60 days of its return to utility sales service to remain on Utility sales service for a minimum of one year before being again eligible to switch to CFY service.

Other Parties
[Insert]

North Shore / Peoples Gas Response

In response, the Utilities modified their proposal to require a customer returning to Utility sales service and not selecting another CFY supplier within 90 days of its return to Utility sales service to remain on Utility sales service for a minimum of one year. NS-PGL Ex. TZ-3.0. The Utilities have three reasons for this requirement. Zack Reb., NS-PGL Ex. TZ-2.0, 57:1271-1283. First, it provides reasonable certainty to their gas supply planning. Second, it prevents customers from switching back and forth between CFY suppliers and the Utilities to take advantage of temporary price fluctuations. Third, it is not substantively different from the minimum terms provisions that CFY suppliers insert in their contracts with customers.

Commission Analysis and Conclusion

The Commission finds that the one year minimum stay provision reflected in the Utilities' revised proposal on this issue is neither unreasonable nor anticompetitive, and the Commission therefore approves the Utilities revised one year minimum stay provision.

3. Rider SBO

a. Billing Credit

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities initially rejected providing any credit. The Utilities pointed out that other than mailing the bill, there would be no cost savings and, even as to mailing, the Utilities may still have to make some customer information mailings. However, upon further consideration the Utilities agreed to provide a 33 cent per customer (per month) credit for CFY suppliers billing under Rider SBO, reflecting their estimate of postage and paper costs. However, the Utilities oppose NAE's further demand that they be ordered to conduct an embedded cost of service study to determine their billing costs and required to file a revised Rider SBO billing credit to reflect the results of the cost study. In the alternative, the Utilities state that if the Commission orders the Utilities to conduct such an embedded cost of service study, there should not be a minimum \$0.33 per bill per monthly SBO billing credit regardless of the results of such study.

Commission Analysis and Conclusion

The Commission finds that it is a reasonable resolution of the dispute between the Utilities and NAE that the Utilities be ordered to provide a \$0.33 per bill per monthly credit under Rider SBO, and the Commission therefore approves that credit. However, the Commission finds that NAE has not shown sufficient justification for ordering the Utilities to conduct an embedded cost of service study to determine their billing costs at this time.

b. Order of Payments

Other Parties

[Insert]

North Shore / Peoples Gas Response

In response to NAE's proposal, the Utilities proposed that the Rider SBO order of payments for partial customer payments be adopted for the LDC single billing option. NS-PGL Ex. TZ-2.0. The Utilities' proposal on this issue addresses the substance of NAE's original complaint as reflected in its Direct Testimony. The Rider SBO order of payments resulted from the Commission's orders in Docket Nos. 01-0469 and 01-0470, while the Commission has never addressed the order of payments under the LDC single billing option. Also, under Section 16-118(b) of the Public Utilities Act, partial customer bill payments made by retail electric customers are to be credited first to the utility's tariffed services, regardless of whether the utility or the alternative retail electric supplier issues the single bill to the retail customer.

Commission Analysis and Conclusion

The Commission finds that the order of payment under Rider SBO and under the utilities consolidated single bill should be identical, and that the Rider SBO order of payments should be applied to the Utilities' consolidated single bill. This order of payments helps to protect a customer from service disconnection due to non-payment of utility tariff charges.

c. NSF Checks

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Utilities believe that the party issuing the single bill-whether it is the utility under the LDC billing option or the CFY supplier under Rider SBO-should bear the risk associated with a customer NSF check that it accepts for payment.

Commission Analysis and Conclusion

The Commission finds that it is appropriate and reasonable that the party accepting an NSF check from a customer bear the collection risk associated with that check. The Commission rejects NAE's proposal on this issue.

4. Purchase of CFY Supplier Receivables

Other Parties

[Insert]

North Shore / Peoples Gas Response

The Commission should not adopt RGS' proposal to compel the Utilities to purchase the receivables of CFY suppliers, nor should it adopt NAE's proposal that the purchase of CFY supplier receivables be expanded to CFY suppliers who have elected the "single billing option." See RGS Ex. 1.0, 31:2 – 34:20; RGS Ex. 2.0, 16:19 - 21:7; NAE Init. Br. At 20. These proposals are unwarranted and inappropriate, for several reasons.

First, Peoples Gas and North Shore are not in the business of offering purchase of receivables service to third parties, they do not wish to offer this service, and their information systems and business processes are not set up to provide this service. NS-PGL Ex. LTB-2.0, 15:317-320. RGS' unsupported assertions that the Utilities have or might have such information systems and business processes are incorrect. NS-PGL Ex. LTB-3.0, 9:178-191. Within the boundaries of governing law, a utility has discretion to manage the conduct of its business. *E.g.*, *Lowden v. Illinois Commerce Commission*, 376 Ill. 225, 231 (1941). No valid grounds have been presented to support the Commission's ordering the Utilities to go into this non-utility line of business.

Second, RGS' proposal is an inappropriate attempt to shift business risks from CFY suppliers to the Utilities and utility customers. NS-PGL Ex. LTB-2.0, 15:320-326. RGS attempts to argue otherwise, but RGS cannot alter the fact that the Utilities do not now have the risks associated with collecting the receivables in question. NS-PGL Ex. LTB-3.0, 9:192 – 10:203. Indeed, the answers of RGS' witness at the evidentiary hearing to questions of the Administrative Law Judges show that, while the CFY suppliers perform credit checks now, they would stop doing so if RGS' proposal were adopted, which would mean that the risk shifted to the Utilities would be much greater than the CFY suppliers' risks now. *See* Tr. 1023:7 – 1025:10.

Third, 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. NS-PGL Ex. LTB-2.0, 15:326-330; NS-PGL Ex. LTB-3.0, 10:204-219. RGS' proposal not only inappropriately interferes with and harms the relationship between the Utilities and their customers, *id.*, but it is inconsistent with the Commission's rules regarding disconnection, which do not provide for disconnection when a customer owes a debt to an alternate supplier, 83 Ill. Adm. Code § 280.130(a). In contrast, CFY suppliers have many mechanisms to avoid and reduce these risks that are not generally available to the Utilities. NS-PGL Ex. LTB-3.0, 10:220 – 11:233.

Fourth, 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. NS-PGL Ex. LTB-2.0, 15:334 – 16:342; NS-PGL Ex. LTB-3.0, 12:256-268; *see also* RGS Ex. 1.0, 31:2 – 34:20; RGS Ex. 2.0, 16:19 – 21:7. At the evidentiary hearing, RGS' witness offered up the theory that no discount is appropriate because this is a base rate case and there can be an increase in the Utilities' uncollectibles expenses recovered through their tariffs. *See* Tr., 1026:12-18. However, there is no data in the record that would come close to providing a basis for calculating how much the Utilities' revenue requirements would need to be increased to offset the shift of risks, burdens, and expenses, especially when, as noted above, the CFY suppliers would abandon credit checks, which would increase the risks, burdens, and expenses.

Fifth, 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 program to gas utilities. NS-PGL Ex. LTB-3.0, 13:269-276. Moreover, Senate Bill 1299, which requires electric utilities with more than 100,000 customers to adopt a purchase of receivables program, is not consistent with RGS' proposal. For example, the legislation provides for “a just and reasonable discount rate to be reviewed and approved by the Commission after notice and hearing. The discount rate shall be based on the electric utility's historical bad debt and any reasonable start-up costs and administrative costs associated with the electric utility's purchase of receivables.” There are no facts in the evidentiary record upon which the Commission could determine an appropriate discount rate. RGS' proposal should be rejected.

Finally, with respect to NAE's proposal that RGS' proposal be expanded to CFY suppliers who have elected the “single billing option,” NAE advanced this position for the first

time in its Initial Brief. NAE Init. Br. At 20. There is no evidence to support this proposal, nor has NAE provided any details about how it would work. NAE's proposal should therefore be rejected.

Commission Analysis and Conclusion

The Commission rejects RGS' and NAE's proposals. RGS has presented no valid grounds to support the Commission's ordering the Utilities to offer purchase of receivables service to third parties. Currently, the CFY suppliers perform credit checks; however, they would stop doing so if RGS' proposal were adopted, which would cause the Utilities to bear a greater credit risk than that currently borne by the CFY suppliers. Further, the CFY suppliers have mechanisms in place to avoid and reduce these risks that are not generally available to the Utilities. There is also no data in the record to guide the Commission in increasing the Utilities revenue requirements to offset the shift of risks, burdens, and expenses, especially when, as noted above, the CFY suppliers would abandon credit checks, which would increase the risks, burdens, and expenses. There are also no facts in the evidentiary record upon which the Commission could determine an appropriate discount rate. With regard to NAE's proposal, there is simply no evidence in the record to support it.

5. PEGASysTM and Customer Information

North Shore / Peoples Gas

The Utilities have proposed substantial improvements to PEGASysTM, the Utilities' electronic bulletin board system, and want to be able to implement them in an orderly, efficient manner. The Utilities state that they have not stood still in connection with PEGASysTM. They made improvements in it from time to time in the past, and they plan substantial additional improvements. Earlier this year, they eliminated the meter number requirement for enrollment purposes and to retrieve 24-month usage histories. They have proposed to eliminate the monthly charges and per minute of usage fees that usually are in effect for a customer's use of PEGASysTM. They also plan to enhance the mechanism by which CFY suppliers interact with the Utilities to process (1) account enrollments, amendments and terminations; (2) billing charges and adjustments; and (3) LIHEAP grants. They also plan to provide a means to permit a customer to extract existing and new reporting data, as well as to enhance certain existing PEGASysTM reports.

Other Parties

[Insert]

North Shore / Peoples Gas' Response

The Utilities reject the rushed, artificial time table being pushed by RGS and NAE for the completion of the planned improvements to PEGASysTM. They want to implement them in an orderly and efficient manner. The Utilities expect to implement all of the PEGASysTM improvements no later than August, 2008, which is the proposed effective date for the revised transportation riders, NS-PGL Ex. TZ-2.0, and perhaps as early as June, 2008. NS-PGL Ex. TZ-3.0. If final orders were issued in these proceedings by February 1, 2008, then the PEGASysTM

enhancements would have to be implemented by March 1, 2008 if the artificial deadline advocated by RGS and NAE were imposed. Mathematically, there is, at most, a five month difference between the implementation time proposed by the Utilities and that proposed by RGS and NAE. The Utilities argue that they should be accorded the discretion to implement these improvements in a cost effective manner pursuant to their proposed schedule, and the artificial deadline proposed by RGS and NAE should be rejected.

Commission Analysis and Conclusion

The Commission finds that the Utilities are in the best position to determine the most orderly and efficient manner in which to implement improvements in PEGASys™, and the Commission believes it would not be reasonable to impose an external deadline for the completion of those improvements given the testimony in the record about the extent of the planned improvements. Therefore, the Commission declines to order that the Utilities complete the PEGASys™ improvements within thirty days of the issuance of a final order in these proceedings.

E. Tariff Corrections and Clarifications

The Utilities have proposed five corrections and clarifications to the proposed transportation tariffs. Each is listed below. No party has objected to any of them. The Utilities also proposed three clarifications to their Terms and Conditions of Service. No party has objected to any of them. The Commission finds them reasonable, and they are approved.

1. Rider SST, Section F

The Utilities propose to add 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. Rider TB, Section A (Peoples Gas Only)

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. Rider LST-T (Peoples Gas Only)

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 propose that the purchase price be 110% of the AMIP.

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

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

The Utilities note that this is not an issue affected transportation customers, but rather sales customers. It was inadvertently left in this portion of the parties’ joint outline, and should probably be moved to an appropriate location for the actual order. It probably should be in a separate section with section X.(B)(7).

a. Service Activation Charges

North Shore/Peoples Gas

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.

Other Parties

[Insert]

North Shore/Peoples Gas Response

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 docket: Harden 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.

Commission Analysis and Conclusion

The Utilities propose to increase the Service Activation Charge, which recovers a portion of the cost related to initiating gas service at a premises. 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 docket: Harden Staff Ex. 9.0, 7:144-8:152. The Commission finds the proposals to increase the Service Activation Charge are acceptable and supported by the evidence in this proceeding.

b. Service Connection Charges

North Shore/Peoples Gas

A Service Reconnection Charge is a charge assessed to a customer whose gas has previously 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-1.03REV, 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.

Other Parties

[Insert]

North Shore/Peoples Gas Response

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, 31:687-695.

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

Commission Analysis and Conclusion

The Utilities propose to increase the Service Reconnection Charge, is a charge assessed to a customer whose gas has previously 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-1.03REV, 27:578-580. The Commission finds the proposals to increase the Service Reconnection Charge are acceptable and supported by the evidence in this proceeding.

c. Second Pulse Data Capability

North Shore/Peoples Gas

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 do 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 propose 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.

Other Parties

[Insert]

North Shore/Peoples Gas' Response

Staff witness Ms. Harden has reviewed North Shore's 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.

Commission Analysis and Conclusion

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. The Commission finds the proposals regarding Second Pulse Data Capability, including the cost-based charge, acceptable and supported by the evidence in this proceeding.

XI. UNION PROPOSALS

Local 18007

[Insert]

Peoples Gas' Response

In accordance with merger conditions the Commission imposed in ICC Docket No. 06-0540 (Order, February 7, 2007), Peoples Gas negotiated with Union Local 18007 regarding, among other things, training and replenishment of union workers and undertaking a hiring plan to fill certain positions. Gennett Dir. UWUA Ex. 1.0, 4:3-14 and 5:10-6:8. During their negotiations, Local 18007 was not able to obtain a promise from Peoples Gas that it would adhere to a rigid and unreasonable “One For One” program requiring the Company to fill all vacated union positions. In this proceeding, Peoples Gas continued to decline to adopt a “One For One” program. Peoples Gas also rejected Local 18007’s modified request that it agree to one-for-one replacements unless undefined technological or infrastructure changes rendered it unnecessary to fill a vacant position. *See* Gennett Reb., UWUA Ex. 2.0, 16:7-11; Gennett, Tr. at 794:14-19. Like Local 18007’s initial “One For One” program, its modified proposal also imposed significant limits (albeit in poorly defined ways) on the role of management and subjected its decisions to unprecedented review, including by the Commission. *See* Gennett, Tr. at 807:17-808:2 and 819:12-822:22.

Peoples Gas argued that the Commission should reject Local 18007’s proposal for two primary reasons. First, the Utilities argued that labor relations is not an appropriate issue for the Commission to regulate. Peoples Gas has a bargaining agreement with Local 18007 that did not require Commission approval, and the Commission should refrain from intervening in disputes that may arise under that agreement. Gennett, Tr. at 822:8-18; 29 U.S.C. § 160(k).

Second, the Utilities argued that adopting Local 18007’s proposal would constitute an unwarranted invasion of Peoples Gas’ management prerogatives. Doerk Reb., NS-PGL Ex. ED-2.0, 5:101-6:113; Borgard Reb., NS-PGL Ex. LTB-2.0, 13:294-14:308. In particular, a straight “One For One” procedure would deprive Peoples Gas of the flexibility to reduce via attrition the ranks of senior positions that are unnecessary. Rather than thwart such a process, the Commission should support it in accordance with the general purposes stated in Section 1-102 of the Public Utilities Act, 220 ILCS 5/1-102, which encourages the Commission to promote efficiency, including efficient allocation of human resources.

Peoples Gas argued that Local 18007 failed to prove that any safety issues compel the Commission to insert itself into a domain normally reserved for management. The only evidence Local 18007 could offer was its belief that Peoples Gas employees make too many “temporary repairs” and that on occasion, take too long to follow up with permanent repairs. Peoples Gas pointed out that no evidence showed or suggested that temporary repairs are unsafe. *See* Doerk, Tr. at 230:11-14, 231:4-8, 234:8-22 and 238:22-239:6. Peoples Gas also argued that no evidence showed or suggested that permanent repairs are systematically or chronically delayed due to

personnel shortages. The only evidence of delay that Local 18007 presented involved a temporary repair that was not replaced for 29 days. However, in that case the permanent repair required a temporary cut-off of gas service to a hospital, which had to be carefully planned and coordinated. Doerk Reb., NS-PGL Ex. ED-2.0, 4:71-80. Thus, the incident did not constitute evidence of an actual safety issue that would justify Commission intervention.

As to Peoples Gas' hiring of eight outside contractors to assist its efforts to cut service to non-paying customers before the beginning of the winter season, Peoples Gas pointed out that this was a task that Local 18007 conceded entry-level employees can safely perform. Doerk, Tr. at 244:220-245:16; Local 18007 Init. Br. at 15-16. Thus, Peoples Gas' conduct did not give rise to a safety issue. Moreover, it was not unreasonable for Peoples Gas to hire temporary workers to perform seasonal service disconnection work as opposed to hiring permanent workers to perform it.

Regarding Local 18007's report and audit proposals, Peoples Gas argued that the Commission should reject them because Local 18007 offered no evidence to support a finding that its proposals were necessary to assure that Peoples Gas provides adequate, efficient, reliable, safe and least-cost service or that an audit would likely be cost-beneficial in enhancing service quality or the reasonableness of rates. *See* 220 ILCS 5/8-102. Peoples Gas further noted that it already has an established compliance monitoring group that audits compliance with its Field Service Manual. Doerk Tr. at 228:17-22.

Commission Analysis and Conclusion

In general, labor relations is not a matter the Commission regulates. As Peoples Gas noted, its labor contract with Local 18007 did not require Commission approval, and the Commission has no jurisdiction to resolve problems that may arise under it. Moreover, Peoples Gas, like other regulated utilities, should have the flexibility to manage employment matters in the most efficient way possible, considering all relevant circumstances. In particular, Peoples Gas should be permitted to determine the appropriate size of its workforce and promote and hire employees as necessary to meet its needs. Accordingly, the Commission will not order Peoples Gas to adhere to any form of Local 18007's "One For One" mandatory employee replacement program.

The Commission also rejects Local 18007's report and audit proposals. Local 18007 failed to present any evidence sufficient to show that its proposals were necessary to assure that Peoples Gas will provide adequate, efficient, reliable, safe and least-cost service or that an audit would likely be cost-beneficial in enhancing service quality or the reasonableness of Peoples Gas' rates.

XII. FINDINGS AND ORDERING PARAGRAPHS

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

- 1) Peoples Gas is an Illinois corporation engaged in the transportation, purchase, storage, distribution and sale of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Public Utilities Act;
- 2) North Shore is an Illinois corporation engaged in the transportation, purchase, storage, distribution and sale of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Public Utilities Act;
- 3) the Commission has jurisdiction over the parties and the subject matter herein;
- 4) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; the Appendix attached hereto provides supporting calculations;
- 5) the test year for the determination of the rates herein found to be just and reasonable should be the 12 months ending September 30, 2006; such test year is appropriate for purposes of this proceeding;
- 6) the \$2,327,999,000 original cost for Peoples Gas and the \$369,442,000 original cost for North Shore of plant at September 30, 2006, as reflected on the Companies' Schedules B-1, Line 1, column D, is unconditionally approved as the original cost of plant
- 7) for the test year ending September 30, 2006, and for the purposes of this proceeding, Peoples Gas' original cost rate base with adjustments is \$1,289,531,000;
- 8) for the test year ending September 30, 2006, and for the purposes of this proceeding, North Shore's original cost rate base with adjustments is \$193,577,000;
- 9) a just and reasonable return which Peoples Gas should be allowed to earn on its net original cost rate base is 8.24%; this rate of return incorporates a return on common equity of 11.06% and costs of long-term debt of 4.67, with a just and reasonable capital structure of 56% common equity and 44% long-term debt;
- 10) a just and reasonable return which North Shore should be allowed to earn on its net original cost rate base is 8.56%; this rate of return incorporates a return on common equity of 11.06% and costs of long-term debt of 5.39%, with a just and reasonable capital structure of 56% common equity and 44% long-term debt;
- 11) Peoples Gas' rate of return set forth in Finding (9) results in approved base rate operating income of \$106,258,000;
- 12) North Shore's rate of return set forth in Finding (10) results in approved base rate operating income of \$10,572,000;

- 13) Peoples Gas' rates, which are presently in effect, are insufficient to generate the operating income necessary to permit Peoples Gas the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;
- 14) North Shore's rates, which are presently in effect, are insufficient to generate the operating income necessary to permit North Shore the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;
- 15) the specific rates proposed by Peoples Gas in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; Peoples Gas' proposed rates should be permanently canceled and annulled consistent with the findings herein;
- 16) the specific rates proposed by North Shore in its initial filing do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; North Shore's proposed rates should be permanently canceled and annulled consistent with the findings herein;
- 17) Peoples Gas should be authorized to place into effect tariff sheets designed to produce annual revenues of \$1,601,375,000, including base rate and rider revenues, which represents a gross increase of \$94,872,000; such revenues will provide Peoples Gas with an opportunity to earn the rate of return set forth in Finding (9) above; based on the record in this proceeding, this return is just and reasonable; [ALTERNATIVE THAT ASSUMES RIDER UBA APPROVAL: Peoples Gas should be authorized to place into effect tariff sheets designed to produce annual revenues of \$1,601,375,000, including base rate and rider revenues, which represents a gross increase of \$68,143,000; such revenues will provide Peoples Gas with an opportunity to earn the rate of return set forth in Finding (9) above; based on the record in this proceeding, this return is just and reasonable;]
- 18) North Shore should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of \$295,581,000, including base rate and rider revenues, which represent a gross increase of \$3,548,000; such revenues will provide North Shore with an opportunity to earn the rate of return set forth in Finding (10) above; based on the record in this proceeding, this return is just and reasonable; [ALTERNATIVE THAT ASSUMES RIDER UBA APPROVAL: North Shore should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of \$295,581,000, including base rate and rider revenues, which represent a gross increase of \$2,006,000; such revenues will provide North Shore with an opportunity to earn the rate of return set forth in Finding (10) above; based on the record in this proceeding, this return is just and reasonable;]

- 19) the determinations regarding cost of service and rate design contained in the prefatory portion of this Order are reasonable for purposes of this proceeding; the tariffs filed by North Shore and Peoples Gas should incorporate the rates and rate design set forth and referred to herein; and
- 20) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than three (3) days after the date of filing, with the tariff sheets to be corrected, if necessary, within that time period.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets presently in effect rendered by The Peoples Gas Light and Coke Company and North Shore Gas Company are hereby permanently canceled and annulled, effective at such time as the new tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general rate increase, filed by The Peoples Gas Light and Coke Company and North Shore Gas Company on _____, are permanently canceled and annulled.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company and North Shore Gas Company are authorized to file new tariff sheets with supporting workpapers in accordance with Findings _____ of this Order, applicable to service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that any motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this _____, 2007.

(SIGNED) CHARLES BOX

Chairman