

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

North Shore Gas Company	:	
	:	
Proposed general increase in natural gas rates (tariffs filed March 9, 2007)	:	Docket No. 07-0241
	:	
	:	(cons.)
The Peoples Gas Light and Coke Company	:	
	:	
	:	Docket No. 07-0242
Proposed general increase in natural gas rates (tariffs filed March 9, 2007)	:	
	:	

**BRIEF ON EXCEPTIONS OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

JOHN C. FEELEY
CARMEN L. FOSCO
ARSHIA JAVAHERIAN
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jfeeley@icc.illinois.gov
cfosco@icc.illinois.gov
ajavaher@icc.illinois.gov

December 14, 2007

*Counsel for the Staff of the
Illinois Commerce Commission*

Table of Contents

	<u>Page</u>
INTRODUCTION.....	1
I. INTRODUCTION	2
II. RATE BASE	2
D. Reserve for Accumulated Depreciation and Amortization	2
1. GCI's Proposed Adjustments	2
E. Cash Working Capital	7
1. Capitalized Payroll and Payroll-Related Expenses	7
2. Pass-Through Taxes	9
3. Real Estate Taxes	9
G. OPEB Liabilities and Pension Asset/Liability	9
III. OPERATING EXPENSES	12
C. Contested Issues	12
1. Storage Expenses	12
a. Crankshaft Repair Expenses (PGL)	12
2. Customer Accounts Expenses (Collection Agency Fees)	15
3. Administrative & General Expenses	17
a. Injuries and Damages Expenses	17
b. Incentive Compensation Expenses	22
IV. RATE OF RETURN	28
A. Capital Structure (Uncontested)	28
C. Cost of Common Equity	28
1. Peoples Gas	28
2. North Shore	29
V. HUB SERVICES (All issues relating to Hub services)	29
A. Manlove Field	29
B. Hub Services	29
C. Hub Procedures – Manlove Capacity Standards	29
VI. WEATHER NORMALIZATION – AVERAGING PERIOD	65
VII. NEW RIDERS	67
A. Overview	67

1. Rider VBA	67
2. Rider WNA	71
C. Rider EEP (Merits of Energy Efficiency Program and Rate Treatment).....	73
VIII. COST OF SERVICE	81
IX. RATE DESIGN	81
C. Service Classification Rate Design.....	81
1. Uncontested Issues.....	81
e. Peoples Gas Service Classification No. 6.....	81
f. Peoples Gas Service Classification No. 8.....	82
2. Contested Issues	82
a. Peoples Gas Service Classification Nos. 1N and 1H.....	82
b. North Shore Service Classification Nos. 1N and 1H	85
c. Peoples Gas Service Classification No. 2.....	85
d. North Shore Service Classification No. 2.....	86
e. North Shore Service Classification No. 3.....	86
f. Peoples Gas Service Classification No. 4.....	86
g. Peoples Gas Service Classification No. 7.....	87
D. Tariffs – Other Tariff Issues	87
3. Rider 4, Extension of Mains	87
X. TRANSPORTATION ISSUES	88
D. Small Volume Transportation Program (Choices for YouSM or “CFY”).....	88
2. Customer Enrollment	88
a. Customer Data Issues	88
XI. UNION PROPOSALS	90
XII. FINDINGS AND ORDERING PARAGRAPHS.....	90
CONCLUSION	92

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

North Shore Gas Company	:	
	:	
Proposed general increase in natural gas rates (tariffs filed March 9, 2007)	:	Docket No. 07-0241
	:	
	:	(cons.)
The Peoples Gas Light and Coke Company	:	
	:	
	:	Docket No. 07-0242
Proposed general increase in natural gas rates (tariffs filed March 9, 2007)	:	
	:	

**BRIEF ON EXCEPTIONS OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code Section 200.830, respectfully submits this Brief on Exceptions to the Proposed Order issued by the Administrative Law Judges ("ALJs") on November 26, 2007 ("Proposed Order" or "PO").

INTRODUCTION

North Shore Gas Company ("North Shore" or the "Company") and The Peoples Gas Light And Coke Company ("Peoples Gas" or the "Company") (collectively referred to as the "Companies") filed new tariff sheets on March 9, 2007 in which the Companies proposed general increase in their natural gas rates and other tariff changes. In

general, the PO reviews the issues presented in this proceeding in a clear and concise manner, is well written, and reflects the positions taken by Staff, the Companies, and the numerous intervening parties. Although Staff supports many of the PO's conclusions, there are items to which Staff takes exception as set forth below.

I. INTRODUCTION

II. RATE BASE

D. Reserve for Accumulated Depreciation and Amortization

1. GCI's Proposed Adjustments¹

While Staff can appreciate the rationale supporting the PO's decision to reject GCI's proposed adjustment to the reserve for accumulated depreciation, Staff strongly recommends that the adjustment to recognize the growth in accumulated depreciation on embedded plant-in-service be given further consideration by the Commission. Staff also recognizes that the issue in Docket No. 05-0597 (ComEd rate proceeding) may be representative of the issue before the Commission in this proceeding, but cautions the Commission that each time an issue is presented and analyzed, a deeper and clearer understanding of the issue and its implications may be realized. Such is the position that Staff finds itself with regard to this issue.

In the PO, the ALJs have based their decision on this issue on the prior order in Docket No. 05-0597 in which the Commission found that updating accumulated

¹ Staff has numbered its exceptions using the outline established in the Proposed Order in compliance with Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code Section 200.830.

depreciation of the embedded plant-in-service to match the date used for plant additions violated Section 287.40 of the 83 Ill. Adm. Code. (PO, p. 20). The emphasis on the adjustment being a violation of Section 287.40 appears to be based upon the Companies attempt to validate the concept by stating: “The proposal [GCI adjustment] also is based on attrition, contrary to the attrition and inflation language of 83 Ill. Adm. Code §287.40...”. (Companies IB, p. 20) However, that conclusion is difficult to support based upon a further analysis of Section 287.40. Thus, based on the analysis presented by the Companies and GCI in their initial briefs, Staff withdrew its opposition to GCI witness Effron’s adjustment and stated that the adjustment did not violate 83 Ill. Adm. Code 287.40 (Staff RB, p. 3).

Mr. Effron’s adjustment is necessary so that net plant-in-service is reflective of the costs and revenues that will be in place for the period during which rates are in effect, a characteristic that the Companies agree is appropriate for pro forma adjustments. (Sep. 10, 2007 Tr. at 130). The test year selected by the Companies is the historical year ending September 30, 2006, with selected pro forma adjustments. The Companies’ test year includes a pro forma adjustment for capital (plant) additions one year beyond the end of the test year or through September 30, 2007. Since the record was marked heard and taken prior to September 30, 2007, the actual net plant-in-service balance was not available to be entered into the record as evidence. But, there is evidence in the record that “from September 30, 2006 to September 30, 2007 (the period covered by the proposed additions to plant) the balance of accumulated depreciation and amortization can be expected to increase by over \$48 million as a result of recording depreciation expense on plant that was in service during the test

year.” (CUB-City IB, p. 13) This would mean that by rejecting the GCI adjustment, PO’s net plant-in-service balance is overstated by at least \$48 million which is the increase to accumulated depreciation for the test year ending September 30, 2007. The PO rejects the GCI proposal to reflect the accumulated depreciation on existing plant through September 30, 2007 because the proposed adjustment would “inappropriately bring the test year into the future for accumulated depreciation. (PO, p. 18) However, the Companies have already brought the test year into the future by updating plant-in-service through September 30, 2007. GCI’s adjustment simply updates the rate base line item that is directly associated with plant-in-service. On one hand the PO approves the Companies’ proposed adjustment to convert the historical test year to a future test year for plant additions, yet rejects the GCI adjustment to update the accumulated depreciation on embedded plant because the adjustment converts the historical test year to a future test year. The same reasoning cannot have merit in one situation and lack merit in another situation.

The Proposed Order further states that “(w)e observe too, that the proposed adjustment does not correlate to *any pro forma capital additions* or any plant adjustment proposed by any party.” (Id., *emphasis added*) However, the Companies’ pro forma capital addition adjustments already converted plant-in-service to the test year ending September 30, 2007. The GCI proposed adjustment simply converted the associated accumulated depreciation balance to the same point in time so that the net plant-in-service balance at September 30, 2007 is representative of the costs and revenues that will be in place for the period during which rates are reflective.

Mr. Effron's adjustment recognizes the recovery of depreciation expense between the September 30, 2006 and September 30, 2007 and balances the effect of increasing test year plant with pro forma capital additions by offsetting those additions with accumulated depreciation on embedded plant through September 30, 2007.

Staff urges the Commission to give the issue further consideration and amend the language of the PO as follows:

Recommended Language:

Commission Analysis and Conclusion

~~All parties agree that this issue has been previously addressed by the Commission. All parties largely agree that the facts differ from one case to another. All parties should agree that Commission action brings certainty to a situation and settles expectations. This is another way of saying that unless there are clear and distinguishable reasons for deciding a case differently, the Commission will follow in line with precedent. To do otherwise risks a charge of arbitrary and capricious action.~~

There is much debate as to which of the decided cases are most reflective of the instant situation. Having reviewed the evidence and the parties' arguments, we find that the facts at hand most closely resemble the situation that we most recently considered in Docket 05-0597 (that concerns Commonwealth Edison Company). In that proceeding, then AG witness Effron proposed to increase through the end of 2005, the entire depreciation pertaining to all plant that went into service prior to and in the 2004 test year. Order at 12, Docket 05-0597. The proposal of GCI witness Effron is essentially the same in this case.

Here, as in Docket 05-0597, the Utilities made depreciation adjustments for post-test year plant that comprises its pro forma additions. Here, as in Docket 05-0597, the Utilities argue that the proposed adjustment is one-sided and unfair. Here, as in Docket 05-0597, the Utilities argue that the proposal presented by the intervening party violates Section 287.40 and test year rate-making principles. Here, as in Docket 05-0597, the Utilities argue that the proposed adjustment merely takes one part of rate base and moves it one additional year into the future. Here, as in Docket 05-0597, the same orders entered in earlier dockets are being asserted by the intervening parties.

In our conclusion for Docket 05-0597, the Commission determined that the same cases that the GCI parties rely on here, were inapplicable and without merit. Order at 15, Docket 05-0597. ~~We further agreed with the assertion (made in this proceeding) that the effect of the proposed adjustment would be to “inappropriately bring the test year into the future for accumulated depreciation. Id. We observed too, that the proposed adjustment does not correlate to any pro forma capital additions or any plant adjustment proposed by any party. In the end, the Commission rejected the AG’s adjustment in Docket 05-0597.~~

We also recognize that each time an issue is before the Commission, a more developed and clearer understanding of the issue and its implications may be realized. Thus, we find that it is appropriate to deviate from the conclusion reached in Docket No. 05-0597 and adopt the adjustment proposed by GCI.

In our view, and under our analysis in this proceeding, the Companies have not convinced us that recognizing one element of growth in post-test year rate base that increases the revenue requirement while ignoring the other directly associated change in the post-test year rate base is appropriate. It is only consistent and logical that the depreciation reserve associated with plant-in-service should be representative of the balance for the same date. To do otherwise, would be the recognition of selective and one-sided adjustments to rate base that result in the pro forma test year rate base exceeding any reasonable estimate of what the rate base will be during the period that the rates are in effect.

In future cases in which this adjustment is presented, additional analysis should be provided for the record to demonstrate whether the test year balance for net plant-in-service is more representative of the actual balance for the period when rates would be in effect with the adoption of the GCI proposed adjustment or with the rejection of the GCI proposed adjustment. ~~the outcome of the 05-0597 proceeding is controlling on the dispute at hand. Indeed, we are shown nothing as would have us depart from the decision that the Commission set out in that matter. Staff’s changed position on reply brief is of no consequence. For their part, the GCI take little or no account of the facts, circumstances or findings in Docket 05-0597. Consistent with our prior and controlling decision on the issue, and for the same reasons, we here reject the GCI’s proposed adjustment.~~

E. Cash Working Capital

1. Capitalized Payroll and Payroll-Related Expenses

Staff disagrees with the PO's conclusion that capitalized payroll should not be included in the cash working capital (CWC) determination (PO, pp. 20-21). The PO fails to recognize that CWC provides the financing of day-to-day operations for cash outlays whether the outlays are capitalized or expenses in nature. (ICC Staff Exhibit 3.0, p. 3) The CWC requirement is intended to adjust rate base to provide a return on the cash needs of the Company to meet their daily cash needs not to provide a return on the ultimate use of the cash. (ICC Staff Exhibit 3.0-Supplemental Corrected, at 4.) A proper CWC analysis represents an analysis of the in-flows and out-flows of cash. Whether cash is used to either pay an expense or to fund an asset, the purpose of the cash outlay is irrelevant in the CWC calculation analysis. Accordingly, the PO's concern about the CWC adjustment potentially allowing a double recovery is misplaced. As Staff pointed out in its reply brief if the potential for a double recovery was a real concern in a CWC analysis, there could never be a CWC requirement since CWC includes an analysis of expenses which will naturally be a component of the revenue requirement. Therefore, the PO's conclusion that capitalized payroll should be excluded from the CWC calculation should be rejected.

Thus, Staff proposes the following language changes to pages 20-21 of the PO:

Recommended Language:

Commission Analysis and Conclusion

~~In the Ameren rate cases, the Commission adopted Staff's recommendation that capitalized payroll costs be included in the CWC calculations. In doing so, we emphasized that Ameren had not included in rate base any payroll costs going forward from the test year." Ameren, at 36. With the absence of capitalized payroll costs in rate base, Ameren~~

would not realize recovery on such costs. Consequently, we were willing to include capitalized payroll costs in Ameren's CWC computation, both because there would be no double recovery on them (i.e., they would not appear in rate base twice) and because fulfilling payroll commitments was a day to day operational obligation of the utility. In these proceedings, however, the pertinent payroll costs appear to be in the Utilities' rate bases. Staff does not claim otherwise. It follows that the precedential rationale for including a capitalized cost in an analysis concerning operational expenses is missing.

The question, then, is whether another rationale for Staff's position exists.

Staff states that "[l]ike cash outlays for items that are expensed, capitalized items must also be paid." Staff Ex. 15.0 at 8. Moreover, Staff emphasizes, "they are paid with the same lead time" as capitalized payroll costs. *Id.* Restating Staff's proposition, because capitalized payroll items behave are financed like expensed payroll items, they belong in the CWC calculation. The Commission does not agree. The relevant accounting rules and test year mechanics are clear—capitalized items enter rate base and operating expenses do not. PGL NS Ex. 3.0 at 14.

The issue here is not adding the actual amount of capitalized payroll a second time through the CWC calculation, but calculating the cost of financing day-to-day operations which includes payroll. CWC only represents the in-flows and out-flows of cash. CWC only considers a cash outlay up to the point that the cash is paid. Thus, the CWC calculation is indifferent as to whether the cash outlay was for an operating expense or a cost to be capitalized. Staff points out that "[t]hese are not long-term capital additions, but cash outlays made on a current basis. One hundred percent of payroll, for example, is paid shortly after the end of the pay period. The Companies could not have made these cash outlays without first having the cash on-hand from some source of cash". Staff Ex. 15.0 at 9. Perhaps the real essence of Staff's argument is that payroll-related costs should not be included in rate base at all (other than as part of the CWC calculation). If so, that argument is unexpressed and certainly undeveloped in this dispute. In any event, the fact that an item requires a cash outlay does not mean it belongs in the CWC determination. Virtually everything a utility purchases involves cash outlay, but the purchase is either capitalized or expensed, not both. Finally—and this point is not part of our decision-making on this issue—it is not apparent to the Commission

~~how reducing CWC, while double counting items in rate base, would reduce customers' bills.~~

2. Pass-Through Taxes

Staff still supports its position that that the separate treatment of real estate taxes would be an appropriate remedy for the Companies' decision to use pass-through taxes in computing lead times for cash outlays, but not in computations involving cash outlay lead dollars. However, after considering the PO's treatment of pass-through taxes on pages 21 - 22 of the PO, Staff no longer considers the separate treatment of real estate taxes to be necessary because the lead-days calculated using all taxes other than income are being applied against all taxes other than income including real estate taxes. Thus, now a separate treatment of real estate taxes would not produce a different result.

3. Real Estate Taxes

See Pass Through Taxes, supra.

G. OPEB Liabilities and Pension Asset/Liability

Staff agrees with the PO that rate base should properly be reduced by the accrued liability for OPEB expenses, \$7,094,000 (\$4,074,000 net of related deferred taxes) for North Shore and \$55,653,000 (\$31,570,000 net of deferred taxes) for Peoples Gas. (PO, p. 35) Staff also agrees that such treatment is dictated by the distinguishing fact that ratepayers, not shareholders, supplied the funds for OPEB obligations. However, it is for this same reason that Staff takes exception to the PO's conclusion that the contributions of North Shore and Peoples Gas to the pension plan during the

test year in the amounts of \$1,862,247 and \$15,278,614, respectively, should offset the rate base reduction of the accrued liability for OPEB expenses. The PO concluded that recognition of such contributions is necessary for fairness, but such treatment would actually result in double recovery from ratepayers since it was ratepayers and not shareholders that contributed the funds.

The PO's regulatory treatment would cause ratepayers to pay pension costs twice: once through pension expense and again in the form of a return to shareholders when pension contributions are paid. This treatment would allow shareholders to earn a return on the amounts contributed to the pension during the test year regardless of the source of those funds. However, the Commission must consider the underlying source of the funds that were contributed to the pension during the test year. Absent a demonstration that such funds were contributed directly by the shareholders (and the record contains no such demonstration), the underlying source of funds is the utility revenues that were collected from ratepayers. Accordingly, shareholders should not receive a return on funds that were supplied by ratepayers. Because pension expense is reflected in the revenue requirement, the Company is and has been charging ratepayers for the cost of the pension plan, and the isolated fact that the Company made contributions to the pension during the test year does not in any way demonstrate that shareholders supplied the funds. Thus, it would have been essential for the Companies to provide evidence that the funds contributed were in fact shareholder funds. Instead, the Company simply paid an obligation that was due, as it would pay any other obligation. Accordingly, the bare fact that a payment was made is not a demonstration that shareholders supplied the funds. Like any other obligation the

Company pays on a routine basis, the funds are presumed to be supplied through rates charged to ratepayers. Accordingly, ratepayers should not have to pay pension costs twice: once through pension expense and again in the form of a return to shareholders when pension contributions are actually paid.

Recommended Language

PO, p. 35

Commission Analysis and Conclusion:

The Commission agrees with the positions asserted by GCI and Staff. Their arguments are persuasive and fully supported by the evidence. Further, they have each established that the treatment we are being urged to assign to this item today, is the same the treatment that we adopted in a number of previous decisions. On all these grounds, the Commission accepts that a rate base deduction of \$7,094,000 (\$4,074,000 net of related deferred taxes) is required for the NS accrued OPEB liability and a rate base deduction of \$55,653,000 (\$31,570,000 net of related deferred taxes) is required for the PGL accrued OPEB liability in the determination of the Utilities' rate bases. See GCI Ex. 2.0 at 13.

~~But~~Further, we note that the underlying rationale for these adjustments is that such funds are supplied by ratepayers and not by shareholders such that shareholders are not entitled to earn a return on these funds. ~~In fairness then, we need recognize~~ Accordingly, the undisputed record showing that Peoples Gas and North Shore contributed \$15,278,614 and \$1,862,247, respectively, to the pension plans during the test year, does not change the treatment of the OPEB liability. Nor are we convinced that such contributions should impact shareholders, given that these funds were provided by ratepayers through the collection of utility revenues. We observe no discussion of or opposition to this particular recalculation that the Utilities propose on basis of their contribution; however, it appears to the Commission that recognizing these contributions is inconsistent with, ~~but the converse of~~, the theoretical basis that we are applying here, i.e, these contributions are ~~not~~ ratepayer-funded.

The Commission finds that the Utilities' OPEB liabilities will be deducted, ~~but and~~, for the reasons provided by ~~the Utilities Staff~~, Peoples Gas' contributions of \$15,278,614 and North Shore's contributions of \$1,862,247 to the pension plan ~~also should~~ not be incorporated into the calculation of the rate bases.

Technical Corrections

Additionally, Staff noted a technical correction to Appendix B to the PO, the North Shore Gas Company Rate Base, page 4 of 15: column (b), line 10, Pension Contribution, reflects \$1,862,000. This amount should be changed to zero, since the Company Rebuttal Adjusted Rate Base (Exhibit SF-2.1N) did not reflect any contribution for pensions.

Staff further noted that the PO fails to include a Rate Base summary for North Shore Gas Company as it does for Peoples Gas Company on page 37 of the ALJPO. Finally, Staff notes that the PO repeats the Operating Statement summary for North Shore on pp 73-75.

III. OPERATING EXPENSES

C. Contested Issues

1. Storage Expenses

a. Crankshaft Repair Expenses (PGL)

Staff does not dispute the PO's factual discussion regarding the expense associated with the repair of Peoples Gas' storage compressor crankshaft; however, Staff does dispute the conclusions associated with that discussion. The PO's conclusion that the proper accounting for the \$546,000 crankshaft repair was to amortize this amount over a four year period instead of concluding that the expense was non-recurring is in error.

The PO accepts the position put forth by GCI that this expense should be amortized over a four year period. This position was later accepted by Peoples Gas. However, GCI witness David Efron agreed with Staff's conclusion that the compressor

repair was a non-recurring item. (ICC Staff Exhibit 23.0, pp. 19-20) Further, Mr. Effron indicated that a utility's actual expenses in a test year should be adjusted to reflect, among other things, the elimination of any abnormal or non-recurring items in order to reflect normal operations in the determination of revenue requirements. (GCI Ex. 2.0, p. 21) In other words, in order to normalize the operation and maintenance expenses of a utility within a rate proceeding, all non-recurring items should be eliminated. This is consistent with Staff's proposal within the instant proceeding.

No party disputed Staff's conclusion that the crankshaft repair should be considered a non-recurring event. In fact, Staff noted that the expected life of the gas compressor was virtually indefinite and was only limited by the ability to obtain replacement parts. (ICC Staff Exhibit 11.0, p. 32) Further, Peoples Gas indicated that over the past 20 years, it had never experienced a major repair whose magnitude was similar to the crankshaft repair that took place in 2006. (Id. at 32-33)

Staff also noted that Peoples Gas did not expect to incur major repairs with its large gas compressors in the foreseeable future. (Id. at 33) Peoples Gas indicated that a technical report titled "Crankshaft Protection: Guidelines for Operators of Slow Speed Integral Engine/Compressors" showed the approximate average probability of incurring a fractured crankshaft is 0.00098 per year and when that probability was applied to Peoples Gas' six compressors that probability indicated an expected frequency of crankshaft failure of once in 170 years. (Id.) Further, Peoples Gas installed electronic bearing temperature sensors in its two largest compressors and programmed those compressors to automatically shut-down if the bearing temperatures exceed specified

limits. (Id.) Peoples Gas indicated that these sensors should even further reduce the likelihood of re-occurrence of the same type of failure. (Id.)

Stated differently, Peoples Gas' own study indicates the frequency of failure for an event similar to one experienced by Peoples Gas with its compressor was at least once in 170 years. Based on this information, Staff determined that the expense associated with the gas compressor repair was a non-recurring expense and that the expense should be disallowed. (Id. at 34)

Peoples Gas' only support for amortizing this expense instead of eliminating it as recommended by Staff is that one should consider the scope of Peoples Gas' distribution operations and that given the span of those operations, it is likely to experience different non-recurring events each year. (North Shore/Peoples Gas Ex. SF-2.0, p. 12) However, Peoples Gas provided no support for this statement, failed to demonstrate the existence of any other non-recurring events from historical periods, and obviously failed to demonstrate that if it had examples of historic non-recurring expenses those expenses were in any fashion equivalent in magnitude to the costs associated with repairing the gas compressor. Therefore, Staff's recommendation to disallow all of the expenses associated with the compressor repair due to its non-recurring nature should be accepted. The current valuation of Staff's adjustment is the difference between Staff's recommendation of \$546,000 and the \$410,000 amount that Peoples Gas agreed upon with GCI, or \$136,000. (ICC Staff Exhibit 23.0, p.20)

PO Language at pages 49-50.

Commission Analysis and Conclusion

No party denies that the expenses were prudent, reasonable, and necessary. No party disputes that the repair expense occurred in the test

year. Likewise, no party disputes that Peoples Gas' repair of the gas compressor was a non-recurring event. Taking these points together, the only question is whether the expense associated with this non-recurring event should be amortized or disallowed.

The Commission accepts Staff's position that the repair expense associated with the crankshaft repair of the storage compressor is properly considered a non-recurring event. Staff demonstrated that this type of repair has a 170 year recurrence frequency for Peoples Gas. Given the highly unlikely nature of a reoccurrence for this repair and Peoples Gas failure to demonstrate it has historically and consistently incurred significant non-recurring expenses of a magnitude similar to the crankshaft repair, the Commission concludes this event is properly viewed as a non-recurring expense and accepts Staff's recommendation to reduce the operations and maintenance expense by \$136,000. 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. This acknowledges that the expense did occur in the test year but is not expected to be a recurring event. It also recognizes that, given the vast scope of its operations, the Utility will, more likely than not, incur another kind of unusual expense. Taking these factors as a whole, the GCI's proposal is fair and appropriate.

Staff makes the point that the crankshaft failure was a very unusual event, but that is only one factor to be considered. Standing alone, it does not support denying all recovery of a prudent, reasonable, and necessary expense.

The amortized amount of \$136,000 is fair and reasonable. It is recommended by GCI's witness and supported by Peoples Gas. GCI Ex. 2.0 at 32-33 and Sched. C-2 (Peoples Gas); NS/PGL Ex. SF-2.0 at 4, 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]. Peoples Gas should be allowed to recover this amount.

2. Customer Accounts Expenses (Collection Agency Fees)

Staff disagrees with the PO's conclusion at page 53 regarding the amount of collection agency fees to be included in the revenue requirement for the reasons previously stated in Staff's Briefs. (Staff IB, pp. 29-31; Staff RB, pp. 13-14) However if the Commission agrees with the PO, the Commission should adopt alternate language to more appropriately present Staff's position and the Commission's interpretation of the

Settlement and its impacts on ensuing proceedings. The suggested language is as follows:

Recommended Language

Commission Analysis and Conclusion

On the basis of the evidence and arguments, 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. We are convinced that the Utilities' adjustments are appropriate in light of the abnormally low test year levels. We accept too, that the methodology they employ yields figures more likely to be representative of the expenses in the years in which the rates established in these proceedings will be in effect.

~~Staff fails to grasp~~ The Commission believes that there are purely tangential effects to the Settlement that have nothing to do with compliance of its terms. As such, ~~Staff's proposal overlooks the fact that~~ the Utilities' 2006 and 2007 collection agency fees were (and likely should have been), vastly understated due to the Gas Charge settlement agreement. This is the only, albeit substantial, significance to be given to the Settlement in this instance and there is nothing improper in so doing. ~~In other words, and c~~ontrary to what Staff would imply, the Utilities' proposal in this proceeding is in no way inconsistent with the terms of the Gas Charge settlement.

However, if the Commission agrees with Staff which it should that the record supports a finding that collection agency fees for the period when the rates being set will be in effect will be less than they were in the pre-2006 Gas Charge settlement numbers selected by the Companies for their proposed normalization adjustment, and that the Companies' proposal attempts to recover costs related to the amount of debt written off in the Settlement by adjusting test year expenses in a manner that completely disregards such write-offs or assumes that such write-offs did not occur, then Staff proposes the following alternate language at page 53 of the PO.

Recommended Language

Commission Analysis and Conclusion

On the basis of the evidence and arguments, the Commission ~~approves~~ rejects the Utilities' adjusted collection agency fees levels and ~~rejects~~ adopts Staff's proposed disallowances of \$1,770,000 for Peoples Gas and \$76,000 for North Shore. We are convinced that the Utilities' adjustments are inappropriate in light of the Settlement ~~abnormally low test year levels~~. We accept too, that the Staff's methodology ~~they employ~~ yields figures more likely to be representative of the expenses in the years in which the rates established in these proceedings will be in effect.

~~Staff fails to grasp that there are purely tangential effects to the Settlement that have nothing to do with compliance of its terms. As such, Staff's proposal overlooks the fact that the Utilities' 2006 and 2007 collection agency fees were (and likely should have been), vastly understated due to the Gas Charge settlement agreement. This is the only, albeit substantial, significance to be given to the Settlement in this instance and there is nothing improper in so doing. In other words, and contrary to what Staff would imply, the Utilities' proposal in this proceeding is in no way inconsistent with the terms of the Gas Charge settlement.~~

3. Administrative & General Expenses

a. Injuries and Damages Expenses

Staff takes exception to the PO's conclusion regarding Injuries and Damages Expenses. The PO finds that the Commission has accepted five-year averaging in other cases, but finds five-year averaging to be incorrect in this case because one of the years, 2002, is different from the others and that the results would change drastically if either three or four years were used. However, Staff has proposed a five year averaging method. To state that the result would be different if the inputs were altered serves no useful purpose because it does not represent Staff's position. Furthermore, the PO punishes Staff for the variation in the 2002 amount "accrued" when its criticism should be directed at the Company as it is the Company's number. As the 2002 data points out, the amount of expenses "accrued" varies from the amount that is ultimately

paid out against claims. In 2002, Peoples Gas accrued \$9,185,000 and paid out \$3,398,000 (Staff Schedule 16.2P, p. 2, Line 1); and North Shore accrued \$1,940,000 and paid out \$232,000. (Staff Schedule 16.2N, p 2, line 1)

The PO makes the inclusion of the 2002 data *the issue*. But the issue applies only to the amount of the expense accrued (not the amount ultimately paid out against injuries and damages claims or whether its inclusion produced a reasonable expense level for rate making purposes). On page 56 of the PO, in the “North Shore/Peoples Gas Response” section, the PO states that “Staff’s exhibits show that the levels for Peoples Gas and North Shore for fiscal years 2002 through 2006 were as follows.” The same presentation is also made on page 40 of the Companies’ reply brief. (NS-PGL RB, p. 40). The PO, in its emulation of the Companies’ reply brief, presents only half of Staff’s analysis. It fails to present column (c), the amount of the injuries and damages paid out for the years 2002-2006, on Schedule 16.2P and 16.2N. The PO also fails to acknowledge the importance of the relationship between accruals and payouts over a multi-year period.

Staff chose the period from 2002 to 2006 because it is the most recent five-year period for which actual data is available and because the Commission had relied on a five year period in the Ameren rate case (Docket Nos. 06-0070, 06-0071, 06-0072, Consol.) for the analysis of injuries and damages expense. The Companies’ injuries and damages data for the most recent 5-years shows the following:

1. The amount of expense accrued varies.
2. The amount (of the accrued expense) ultimately paid out also varies.
3. In no year did the amount of the accrual equal the amount of the payout.

The data does not support the conclusion reached by the PO that the amount of the “accrued” test year expense (i.e., \$6,192,000 for Peoples Gas and \$477,000 for North Shore) should be the expense allowance for rate case purposes (See item 3 above). The point is, Peoples Gas and North Shore Gas, on average, over-accrued (or over estimated) the amount of injuries and damages expense that is ultimately paid out. (See, Staff Schedules 16.2P and 16.2N, column (b) line 5, compared to the five year average payout amount on line 9 (\$5,242,000 and \$373,000 for Peoples Gas and North Shore Gas, respectively) Staff is not advocating that any single or any two year’s data be viewed in isolation. For example, Peoples Gas had 2005 and 2006 injuries and damage payouts of \$4,497,000 and \$4,522,000 based upon accruals of \$6,502,000 and \$6,192,000, respectively. (ICC Staff Exhibit 16.0, Schedule 16.2P, p. 2, lines 4-5). As a point of illustration, the above payouts of \$4.497 M and \$4.522 M total \$9.019 M for an average payout of \$4.510 M. Viewed from this perspective, it is difficult for the PO to support \$6,192,000 injuries and damages expense allowance for Peoples Gas when the average payout for the two most recent years is \$4,510,000.

If the above two-year analysis is applied to North Shore, the results are skewed. North Shore had payouts of \$1,306,000 and \$421,000 for 2005 and 2006; \$1,727,000 in total or an average payout of \$863,500. No one is suggesting an \$863,500 expense allowance for injuries and damages when the accrued expenses for the two most recent years are \$415,000 (2005) and \$477,000 (2006). Staff Schedule 16.2N, p. 2, lines 4-5. For these reasons, Staff believes that both the accrued expenses and the related payout, over a period of years, should be considered when developing the appropriate expense level for rate case purposes.

Upon a closer review of the data for Peoples Gas, the 2002 accrued expense of \$9,185,000 does not appear so unreasonable in light of the payouts of \$6,870,000 and \$7,929,000 for 2003 and 2004 respectively (i.e., a large accrual is followed by a large payout). Staff's position is, that over-time [and this is demonstrated in Staff Schedule 16.2P, Columns (b) and (c), lines 1-5], Peoples Gas will ultimately payout 84.65% of the injuries and damage claims. Thus, Staff's \$5,242,000 allowance for injuries and damages is reasonable and should be adopted by the Commission.

The pattern is similar for North Shore. In 2002 it accrued \$1,940,000 for injuries and damages. Subsequently, a large payout of \$532,000 of accrued expenses occurred in 2004, followed in 2005 by an even larger payout of \$1,306,000. (Staff Exhibit 16.2N, p. 2, lines 1-4) Staff's position is, that over-time, North Shore Gas will ultimately payout 78.26% of its accrued injuries and damages expenses. Thus, the \$373,000 expense allowance (78.26% of accrued expenses for the period 2002-2006) for injuries and damages is reasonable.

The Commission's Order with respect to injuries and damages must demonstrate two concepts. First, that one-year's accruals or one year of data should not be looked at in isolation; and second, that the selected expense methodology produces a reasonable and supportable allowance for ratemaking purposes. Injuries and damages expense is one of the costs incurred by a utility that is subject to fluctuation and is difficult to predict from year to year. For this reason it is appropriate, for rate making purposes, to normalize such costs. The fact that one of the years in the 5-year average is noticeably different than the others only proves the point. There is no reason why any of the years before the next rate case could not experience injuries and damages

expense that is just as noticeably different. So far as the result being different depending on the number of years that is used in the averaging is concerned, using a consistent number of years in rate cases before the Commission is the way to prevent an arbitrary number of years from being used from case to case depending on which number of years benefit various parties. Since the Commission has accepted five-year averaging in other cases it is reasonable to accept a five year average in this case for consistency.

For these reasons, Staff respectfully requests that the ALJs substitute the following language under "Commission Analysis and Conclusion":

Recommended Language:

PO, pp. 56-57

Commission Analysis and Conclusion

~~We see from the record that depending on the time periods selected for normalizing, the results will either be fair or skewed. While this Commission has accepted 5-year averaging in other cases, this is obviously not a hard and fast rule. It is always necessary, when gathering any periods of data, to further apply sound and reasoned judgment. Here, we are not persuaded by the correctness of using 5 years of data for reasons that one of these years, i.e., 2002, is clearly and unmistakably different from the others. Further, we perceive that something is inherently wrong in the selection when the results change so drastically when either 3 or 4 year data is considered. So too, we are not convinced that Staff's normalization required the complex methodology that it applied especially where plain averaging has been utilized in past cases. And, we see that the use of averaging also would have produced different results. For all these reasons, and because we are not persuaded that normalization was ever required in this instance, we reject Staff's proposed adjustments.~~

~~In the final analysis, the Commission 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. No adjustments need be made.~~

We agree with Staff that Injuries and Damages Expenses can vary greatly from year to year and it is therefore more appropriate to normalize these expenses for rate making purposes. We also agree with North Shore/Peoples Gas argument that the results of the normalization calculation can vary greatly depending on the number of years that are averaged. It is therefore reasonable to use a number of years that is consistent with what the Commission has used in past cases so the result will not be arbitrary. We therefore find that Staffs use of a five-year averaging period is appropriate. Staff's position that North Shores and Peoples Gas' Injuries and Damages expense for rate making purposes should be \$373,000 and \$5,242,000 respectively is accepted.

b. Incentive Compensation Expenses

Staff strongly agrees with the PO conclusion that the Company's assertion that it must offer incentive compensation plans "to attract and retain a qualified workforce" is not sufficient reason to allow these expenses to be recovered from ratepayers. (PO, p. 66) Staff further agrees that the STIC, Affiliate Charges, Restricted Stock and Performance Shares fail to demonstrate the cost saving or other direct ratepayer benefits that the Commission generally requires. (Id.) However, Staff disagrees with the PO's conclusion that portions of the TIA Plan and all of the IPB Plan should be recovered through rates.

Staff is still concerned that the array of measurement components included within the TIA Plan allows the incentive criteria to change from year to year. Accordingly, even if a portion of the criteria that were utilized during the test year were deemed beneficial to ratepayers, there is no reason to believe those criteria will be the same in future years, especially since they are only a part of the plan, they could easily be removed in favor of increasing the benefits of another part of the incentive plan. Accordingly, Staff

would argue that this Plan is discretionary on two fronts: the performance criteria within the Plan are discretionary, and the Plan itself is discretionary. Accordingly, ratepayers are exposed to the real possibility that rates may include the cost of a Plan with little benefit to them or, even worse, that rates could include the cost of a Plan for which the Company incurred no expense. Staff's concern about the discretionary nature of incentive compensation plans extends to the IPB Plan, as well. As Staff noted in testimony and briefs, the IPB Plan was only in place during the 2006 test year. Accordingly, there is no history to refute Staff's contention that this Plan is discretionary. Additionally, there is a long-standing Commission requirement that the costs of such plans should only be recovered from ratepayers when the plans provide demonstrated benefits and/or cost savings to ratepayers, which the Companies would have an opportunity to demonstrate in their next rate case. The record contains no evidence that this test has been met for the IPB Plan. The evidence simply shows that incentive payments totaling \$625,791 and \$53,107 for Peoples Gas and North Shore, respectively, were paid to 426 different employees. The bare assertion that these awards were not based on the financial performance of the company does not mean the incentives necessarily benefited ratepayers. Nor does the assertion that the IPB Plan benefits customers by encouraging outstanding individual work performance satisfy the long-standing test of **demonstrated** benefits and/or cost savings to ratepayers. Accordingly, Staff urges the Commission to deny recovery of the costs of all incentive compensation plans. In the alternative, if the Commission is determined to allow some portion of incentive compensation expense to be recovered through rates, Staff

suggests alternative language to deny all costs of the IPB plan for the reasons stated previously and only allow recovery of a portion of the TIA Plan.

Recommended Language

PO, p. 66

Commission Analysis and Conclusion:

Before us on this issue are two conflicting views. While the Utilities assert that all parts of their incentive programs meet the standard for recovery, Staff, CUB and the AG would generally argue that none of these plans satisfy the test. As such, the Commission is put to the task of examining the record and applying its reasoned judgment informed by all of the relevant circumstances.

The record shows that there are as many instances where the Commission has approved incentive compensation as there are cases where such an expense has been denied. The main and guiding criterion is that the expense be prudent, reasonable and operate in a way to benefit the utility's customers. It is in this light that we consider the particulars of the programs, the amounts paid out, to whom and why, and what this all means to the Utilities' customers.

We agree with Staff that ~~three~~ all of the five plans (STIC, TIA, IPB, Affiliate Charges, Restricted Stock & Performance Shares) fail to demonstrate the cost savings or other direct ratepayer benefits that we require. While these plans may indeed be necessary "to attract and retain a qualified workforce" this is not reason enough to allow the expense. ~~The remaining two plans, however, bring different concepts into focus.~~

~~Being a large utility means that management depends on the dutiful work performance of its non-executive employees. To motivate and maintain high standards, a utility may reasonably believe that incentive compensation is the best way to match both employer and employee interests. And, when matters of customer service, customer satisfaction and the reduction of operating expenses is at issue, it is incumbent upon the Commission to take a close and considered view. It is on this basis that we turn our attention to the Utilities' non-executive TIA and IPB Plans.~~

The TIA Plan

~~This Plan applies to non-officer employees. As to its particulars, the Utilities' surrebuttal testimony effectively disputes Staff's claim that controlling O & M expenses should not count. It further shows that in the 2006 test year the aggregate actual O & M expenses were about \$11~~

~~million below budget. Under the Plan, 25% of the measures were based on controlling these very expenses and we consider this as beneficial to ratepayers.~~

~~We further see that another 10% of the measures are tied to the number of phone calls made to the call centers. Even Staff recognizes the value of motivating this work. Further there is a measure of 10% associated with gas expenses and Gas Charges that we also believe should be counted. Finally, other unchallenged evidence of record confirms that 67.2% of the total payments were based on measures for controlling O & M expenses (48.4%) and call centers (18.8%). On this basis, the Utilities derive their alternative proposal.~~

IPB Plan

~~The IPB plan is also a non-executive program that is aimed at encouraging outstanding individual work. It is uncontested that the awards are not based on financial performances. The record shows that the IPB awards went to 426 different employees, and were paid out in an average amount of \$2,884.53. Taken together, the goal of the plan, the large pool of potential awardees and the wide-reaching motivational impact, make it more likely than not, that ratepayers will benefit from the race to excellence.~~

~~We do not share Staff's concerns as to possible changes or discontinuances of these Plans. The Commission finds that Peoples Gas and North Shore have demonstrated a steadfast commitment to incentive compensation in that they recognize the value, if not the necessity, of providing incentive compensation going forward. We would expect that if changes were to occur, these would equally go to the benefit of ratepayers.~~

~~In the final analysis, the Commission concludes that Peoples Gas and North Shore should be allowed to recover \$1,009,240 for Peoples Gas, and \$94,024 for North Shore for costs associated with the operational measures of the "TIA" plan.~~

~~Further, we allow the amounts of \$625,791 for Peoples Gas, and \$53,107 for North Shore, under the "IPB" plan, which is tied to individual performance and not to any financial measures. These costs are reasonable and prudent, and we perceive them to benefit the Utilities' customers.~~

In the final analysis, the Commission concludes that Peoples Gas and North Shore should be allowed to recover none of the costs associated with incentive compensation plans during the 2006 test year.

However, if the Commission is determined to allow some portion of incentive compensation expense to be recovered through rates, Staff suggests the following alternative language to allow recovery of a portion of the TIA Plan but not recovery for the IPB plans for the reasons stated previously, as follows:

Alternative Proposed Modification
(PO, p. 66)

Before us on this issue are two conflicting views. While the Utilities assert that all parts of their incentive programs meet the standard for recovery, Staff, CUB and the AG would generally argue that none of these plans satisfy the test. As such, the Commission is put to the task of examining the record and applying its reasoned judgment informed by all of the relevant circumstances.

The record shows that there are as many instances where the Commission has approved incentive compensation as there are cases where such an expense has been denied. The main and guiding criterion is that the expense be prudent, reasonable and operate in a way to benefit the utility's customers. It is in this light that we consider the particulars of the programs, the amounts paid out, to whom and why, and what this all means to the Utilities' customers.

We agree with Staff that ~~three~~ four of the five plans (STIC, IPB, Affiliate Charges, Restricted Stock & Performance Shares) fail to demonstrate the cost saving or other direct ratepayer benefit that we require. While these plans may indeed be necessary "to attract and retain a qualified workforce" this is not reason enough to allow the expense. The remaining ~~two~~ plans, however, brings different concepts into focus.

Being a large utility means that management depends on the dutiful work performance of its non-executive employees. To motivate and maintain high standards, a utility may reasonably believe that incentive compensation is the best way to match both employer and employee interests. And, when matters of customer service, customer satisfaction and the reduction of operating expenses is at issue, it is incumbent upon the Commission to take a close and considered view. It is on this basis that we turn our attention to the Utilities' non-executive TIA ~~and IPB~~ Plans.

The TIA Plan

This Plan applies to non-officer employees. As to its particulars, the Utilities' surrebuttal testimony effectively disputes Staff's claim that controlling O & M expenses should not count. It further shows that in the 2006 test year the aggregate actual O & M expenses were about \$11 million below budget. Under the Plan, 25% of the measures were based

on controlling these very expenses and we consider this as beneficial to ratepayers.

We further see that another 10% of the measures are tied to the number of phone calls made to the call centers. Even Staff also recognizes the value of motivating this work. Further there is a measure of 10% associated with gas expenses and Gas Charges that we also believe should be counted. Finally, other unchallenged evidence of record confirms that 67.2% of the total payments were based on measures for controlling O & M expenses (48.4%) and call centers (18.8%). On this basis, the Utilities derive their alternative proposal.

IPB Plan

~~The IPB plan is also a non-executive program that is aimed at encouraging outstanding individual work. It is uncontested that the awards are not based on financial performances. The record shows that the IPB awards went to 426 different employees, and were paid out in an average amount of \$2,884.53. Taken together, the goal of the plan, the large pool of potential awardees and the wide-reaching motivational impact, make it more likely than not, that ratepayers will benefit from the race to excellence.~~

~~We do not share Staff's concerns as to possible changes or discontinuances of these Plans. The Commission finds that Peoples Gas and North Shore have demonstrated a steadfast commitment to incentive compensation in that they recognize the value, if not the necessity, of providing incentive compensation going forward. We would expect that if changes were to occur, these would equally go to the benefit of ratepayers.~~

In the final analysis, the Commission concludes that Peoples Gas and North Shore should be allowed to recover \$1,009,240 for Peoples Gas, and \$94,024 for North Shore for costs associated with the operational measures of the "TIA" plan.

~~Further, we allow the amounts of \$625,791 for Peoples Gas, and \$53,107 for North Shore, under the "IPB" plan, which is tied to individual performance and not to any financial measures. These costs are reasonable and prudent, and we perceive them to benefit the Utilities' customers.~~

IV. RATE OF RETURN

A. Capital Structure (Uncontested)

The PO adopts the imputed capital structures proposed by North Shore and Peoples Gas. (PO, p. 76) While Staff did not take issue with those capital structures which the PO' appropriately reflects, the PO does not contain the caution which Staff expressed as part of its decision in making that recommendation. To more fairly present Staff's position on this issue, Staff recommends the following changes to the PO.

Recommended Language

A. Capital Structure

* * *

Staff recommends utilizing the imputed capital structures proposed by North Shore and Peoples Gas. Staff had several basis for supporting the imputed capital structure set forth in its testimony, but cautioned that in future cases Staff may recommend rejecting the Companies' capital structures if they are not consistent with that of Integrys as a whole, taking differences in operating risk into account. Staff, however, argues that under no circumstances should the Commission accept the Companies' proposed capital structures without also accepting Staff's proposed adjustments to the Companies' cost of common equity and debt.

C. Cost of Common Equity

1. Peoples Gas

The PO has a typo at page 92, in the 2nd full paragraph, in the fourth line. The word "annual" should be changed to "quarterly". The support for this position is that the paragraph states that the "Commission finds that the quarterly version of the DCF model is superior." (PO, p. 92), however in the next sentence the PO states that "We

remain convinced, as we have been in numerous previous rate cases, that the annual version of the model should be used to correctly reflect the time sensitive value of the dividends reflected in the DCF model.” (Id.)(emphasis added). Clearly, the PO meant to use the word “quarterly” rather than “annual” in that sentence. Staff recommends the following change.

Recommend Language

* * *

City/CUB used an annual version of the DCF model and objects to the quarterly version used by the Staff and the Utilities. The Commission finds that the quarterly version of the DCF model is superior. We remain convinced, as we have been in numerous previous rate cases, that the ~~annual~~ quarterly version of the model should be used to correctly reflect the time sensitive value of the dividends reflected in the DCF model. Mr. Thomas’ arguments, which the Commission has considered in previous cases, have not altered our view.-

2. North Shore

V. HUB SERVICES (All issues relating to Hub services)

A. Manlove Field

B. Hub Services

C. Hub Procedures – Manlove Capacity Standards

The PO fails to consider Peoples Gas’s past history

The PO’s discussion and conclusions on the Hub have failed to consider the recent history regarding Peoples Gas’s actions related to the creation and operation of the Hub. Unfortunately, Peoples Gas recent past consists of creating ventures, including the Hub, whose purpose was to maximize shareholder profits while assigning all or most of the costs associated with those ventures to ratepayers. Staff’s analysis

and review in the instant proceeding shows that the Hub operations also fall under this category, and Staff would implore the Commission to not allow Peoples Gas the opportunity to subject ratepayers to such one-sided ventures.

The Hub was started in conjunction with Peoples Gas' corporate parent, Peoples Energy Corporation ("PEC"), initiating a strategic partnership with Enron. (ICC Staff Exhibit 12.0 Revised, p. 13) The strategic partnership used gas transactions between the two partners to generate unregulated profits, which the partners then split between them. PEC's shareholders obviously benefited from these deals, but the Companies' ratepayers either saw few benefits from or even paid higher prices due to the transaction. (Id.) The Hub was an important tool in the partnership between Enron and PEC. In addition, Peoples Gas diverted Manlove Field usage from Company supply to Hub services. At peak usage, Peoples Gas continued to deliver Hub gas to third party customers and forced utility ratepayers to pay high spot gas prices. The two entities also shared Hub profits. (Id. at 13-14)

Ratepayers paid higher costs in Rider 2 because of the strategic partnership for two reasons. As discussed above, Peoples Gas ratepayers supported the Hub by funding high-priced, flowing gas. Also, Peoples Gas did not flow Hub revenues through the PGA (that is, it did not record the revenues as offsets to gas costs in the PGA).² But, it did flow the costs to expand Manlove Field through the PGA to ratepayers beginning in April 1999. At that time, Peoples Gas began recording 2% of total Manlove Field gas injections as "maintenance gas."³ The resulting costs were recovered in the

² Peoples Gas did record the revenues above the line as an offset against base rate gas costs.

³ Maintenance gas is base gas.

PGA.⁴ (Id. at 17-18) Recovering maintenance gas in the PGA granted the Company the ability to immediately recover its base gas costs through the PGA. In other words, Peoples Gas recovered its capital costs to expand the field for non-ratepayer services from Illinois ratepayers immediately, postponed the need to file a rate case, and, in the meantime, retained the Hub revenues for shareholders. This arrangement gave a strong incentive to the Company to offer Hub services even when ratepayers would be worse off. (Id. at 18)

In Docket No. 01-0707, Peoples Gas accepted Staff's adjustment to remove maintenance gas costs from the PGA (ICC Docket No. 01-0707, Order Dated March 28, 2006, p. 81) The 01-0707 Order also indicated that Peoples Gas had historically recovered maintenance gas through base rates. (Id.) In other words, it was recognized that by removing the costs of maintenance gas from the PGA, the maintenance gas issue was a rate base concern. Therefore, even though Peoples Gas' decisions regarding Hub operations occurred hand in hand with the events discussed in 01-0707, the impact that Hub operations had on the Manlove storage field and the need for base gas to support Hub operations could not be addressed until Peoples Gas filed the instant proceeding.

The Commission used the Final Order in Docket 01-0707 to inveigh against Peoples Gas' behavior. It included an entire section in the Final Order devoted to detailing the bad faith exhibited by Peoples Gas. The Commission recognized that utility regulation is difficult, if not impossible, without the utility being forthcoming on the facts and behavior. When a utility subverts its entire purpose for shareholder profits and

tries to hide its behavior, then the Commission should not give the benefit of the doubt to that utility. Unfortunately, it appears the Proposed Order does just that.

The 01-0707 Order described the Company's conduct in stark terms:

[The Company's behavior] ...during this period move[d] beyond mere imprudence to being egregious. PGL entangled itself in a clever corporate web with its parent company, its affiliates and Enron designed to use PGA assets, assets designated to serve PGL's ratepayers, solely for the gain of the entities involved. ... PGL flouted the law and Commission rules, completely disregarded its duty to its PGA customers and jeopardized its credibility. Over the next few years, the Commission intends to closely scrutinized PGL through the audits agreed to in the Settlement Agreement ... in hopes that its conduct during this reconciliation is an aberration."

(Docket No. 01-0707, Order Dated March 28, 2006, p.138) The Final Order also noted that "...PGL engaged in certain agreements and transactions with Enovate and Enron MW that were designed to evade Commission detection. That PGL proceeded in these affiliate interest agreements and transactions without prior Commission approval is an astonishing disregard for and circumvention of the Public Utilities Act and Commission rules." (Id. at 139) In other words, Peoples Gas was subverted for the profit of Peoples Energy Corporation shareholders. And the Commission would have to watch Peoples Gas closely to ensure that it did not happen again.⁵

Finally, the Commission noted in the Order that one consequence of its actions was to raise suspicions about whether Peoples Gas could be trusted to fulfill its utility purpose. "The Commission's confidence in PGL's management to be forthright and fair in serving ratepayer interests and in dealing with this Commission is shaken. The Commission believes that its regulatory compact with PGL, its presumption of good faith

⁵ It should be noted that Peoples Gas Corporation (parent of Peoples Gas) entered into a merger with WPS Resources Corporation in Docket No. 06-0540 that the Commission approved on February 7, 2007. Given the short time period since the merger approval it is not possible to determine if Peoples Gas' behavior has improved.

on the part of PGL's management, and PGL's overall integrity as a corporate citizen is severely damaged by the instant case." (Id. at 140)

The PO errs in rejecting Staff's estimate of 45 bcf of base gas.

The PO erred in reaching the conclusion that only 1.34 MMDth of cushion gas injections should be assigned to Hub operations (PO, p. 101) and in determining Staff's position that Manlove will eventually need about 45 Bcf of base gas to support the current volume of Hub operations is pure speculation. (PO, p. 111) These conclusions ignore Peoples Gas dismissal of the Commission directives from prior proceedings to address the base gas issue, Peoples Gas' own consultants, Staff's analysis, as well as a prior Commission Order. This information demonstrates that the base gas requirements associated with Hub operations greatly exceed the 1.34 MMDth amount determined by the Proposed Order, and that Staff's estimate of 45 Bcf for the base gas needs for Hub operations is reasonable. The result of the Proposed Order's Conclusion is to reward Peoples Gas for its failure to directly address a known issue by allowing Peoples Gas to focus only on the result of mixing ratepayer and Hub operations gas, instead of focusing on the impact the Hub currently has and will have in the future on the operation of the Manlove storage field.

1. Commission Directive

The Proposed Order fails to discuss or account for the fact that Peoples Gas failed to conduct any studies to determine the specific amount of base gas needed for Hub operations. This failure is significant because in Docket No. 01-0707 it was agreed that issues relating to the base gas needs associated with Hub operations would be

addressed in Peoples Gas' next rate case instead of Docket No. 01-0707. Within that same proceeding, Staff also specifically requested Peoples Gas conduct a study to determine the base gas requirements caused by the Hub operations. (ICC Staff Exhibit 10.0, pp. 19-20) However, Peoples Gas ignored the commitments placed upon it by the Commission, and has continually failed to address the issue of how much base gas is necessary to support Hub operations. (Id. at 19-21)

Instead, Peoples Gas' initial and primary argument in the instant proceeding was that the Hub operations should be assigned no base gas amounts. It was only after Staff questioned this obvious inequity that Peoples Gas created its fall back position that estimated the base gas amount was potentially 1.34 MMDth. However, this Peoples Gas' calculation of this amount is a simple allocation of maintenance gas after Hub operations were created and ignores the immediate creation of base gas by the additional injections. Staff also demonstrated, as summarized below, that the 1.34 MMDth is a pittance compared to the ultimate amount that Peoples Gas will attempt to foist off onto ratepayers. Further, the Hub operations base gas amount adopted by the PO is not supported by any studies that Peoples Gas conducted on this issue, but instead merely represents the opinions of Peoples Gas' witnesses – the same witnesses that did not know who authorized or how the Hub operations were ever initiated in the first place (Tr. 454-455 and 531). Further, the opinions are arrived at by merely pro-rating the existing base gas additions by the percentage of inventory assigned to each use of the Hub.

2. Consultant Studies

Peoples Gas' own studies demonstrate that Peoples Gas' claims that no base gas, or its late coming claim of 1.34 MMDth of base gas requirements associated with Hub operations, are false. Peoples Gas' February 3, 2003, Report entitled "Manlove Field Trapped Gas Report" discusses gas entering virgin areas of an aquifer, including what occurs when an aquifer is expanded or grown. This report (Peoples Gas Ex. TLP-1.1, p. 30) noted that, "The above observations are consistent with past estimates that 56% of gas that moves into virgin aquifer pore space is trapped or lost. Some growth will occur in pore volumes already containing gas, and a much smaller fraction of that gas will be lost. However, most continued growth will invade virgin aquifer with lost gas on the order of 50%." (Peoples Gas Ex. TLP-1.1, p. 30 and ICC Staff Exhibit 22.0, p. 14, emphasis added) Further, the same report indicated "Some growth will occur in pore volumes already containing gas, and a much smaller fraction of that gas will be lost." In other words, anytime additional gas is injected into Manlove a significant amount of that gas is lost. This viewpoint is also consistent with Staff's historical ratio review of Manlove that showed over 75% of the gas in Manlove was base gas.

Just to clarify the significance of the above statements, it is not disputed that Peoples Gas expanded the Manlove storage field to provide Hub services and that the current working inventory volumes allocated to the Hub operations is 10.2 Bcf (a MMDth is roughly equivalent to a BCF). The report also indicates that as that gas was injected, around 50% of that gas immediately became lost (meaning it is not recoverable and should be considered base gas). In other words, at a minimum Peoples Gas' report indicates that the 10.2 Bcf expansion of Manlove immediately caused around 50% of that gas, or about 5.1 Bcf, to become lost within the reservoir formation. Further, this

amount does not account for how much additional base gas is needed to support a 10.2 Bcf withdrawal amount, but it does clearly demonstrate that Peoples Gas' claim that no base gas or only 1.34 MMDth of it should be allocated to Hub operations is clearly wishful thinking.

This same February 3, 2003, report (Peoples Gas Ex. TLP-1.1, p. 2) also discusses basic aquifer operation, gas saturation, and trapped or lost gas (base gas). In particular, the report noted that "Pressures are necessarily above the initial aquifer pressure most of the time in Manlove. During this time, gas is continually moving from the working gas area into pores that previously had little or no gas saturation. A large fraction of that gas will become trapped, and consequently lost. If this lost gas is not replaced, the effective working gas will decrease by replacing the lost gas itself, and long-term deterioration in field performance will occur...." (ICC Staff Exhibit 22.0, pp. 14-15) In other words, all additional gas injected into Manlove, (i.e. Hub expansion) forces the field to expand into areas that previously had little or no (virgin) gas or increases gas saturation in existing gas saturated areas by displacing water, both resulting in lost gas.

The obvious truth is that once the reservoir is created, which Peoples Gas did with Manlove in the mid 1960's, all gas additions from that point forward caused the field to expand and this expansion occurs radially and invades new areas of the reservoir. When this occurs, additional gas is trapped, increasing the total base gas volumes maintained by the field. This statement directly correlates with Peoples Gas' explanation that additional gas injected in the Manlove Field expands radially invading new areas when the Manlove field requires maintenance or base gas injections and is also consistent with Staff's testimony that discusses the need for base gas due to the

field expansion for Hub operations; but it is inconsistent with Peoples Gas' claims that there was no need for additional base gas when the working inventory in Manlove was expanded for Hub services. (ICC Staff Exhibit 22.0, pp. 22-24)

All gas injected into the field behaves in the same manner, Peoples Gas just wishes to treat the Hub expansion gas in a different manner. Peoples Gas wants the Commission to believe that only ratepayer gas migrates in Manlove, and that the gas inventory for the Hub does not migrate. The Company's position is illogical. All the gas injected into Manlove is above the pressure of the water in the aquifer and will expand and become lost or trapped -- whether it is ratepayer or Hub gas. There are no individually marked sections of the aquifer to draw from, nor do the gas molecules retain their "Hub" or "ratepayer" IDs. Thus, Peoples Gas' own testimony is inconsistent with the resulting claims it makes regarding Hub operations. There is no set of assumptions that Peoples Gas can create to logically reach its desired result that the Hub requires no base gas, or that its fall back position of only 1.34 MMDth is reasonable.

3. Prior Commission Order Regarding Storage Expansion

The Proposed Order conclusion regarding the base gas needs for the Manlove storage field created by the Hub expansion is also at odds with prior Commission Orders. In Docket No. 91-0499, Illinois Power Company ("IP") requested a certificate of public convenience and necessity to construct certain pipeline facilities that were necessary due to its planned expansion of its Hillsboro aquifer storage field. IP's economic analysis that supported the need for the storage expansion and additional pipeline facilities indicated that the storage expansion would involve an additional 4.5 Bcf of working gas and 7.0 Bcf of cushion or base gas (11.5 Bcf in total). (ICC Docket

No. 91-0499, Order Dated October 21, 1992, p. 8) IP also indicated that the gas was being injected over a three year period. (Id.) In other words, the last storage field expansion reported to the Commission involved a need to add a significant amount of base gas to support the withdrawal of additional working gas inventory.

Staff also indicated that the Manlove Field's geology is unique. In particular, Staff's witness noted that the Manlove storage field is a very poor reservoir and was one of the worst operating aquifer storage fields he was aware of in terms of the amount of base gas required to support its working gas amounts. (Tr. 489) Further, Staff's witness indicated that, in rough numbers, other fields that he operated had about one-third working inventory, one-third recoverable base, and one-third non-recoverable base within the reservoir. However, the Manlove Field historic ratios had a base gas requirement of about 75 to 80 percent with only 20 percent of the gas being working inventory (and only 4% of total base gas classified as recoverable). (Tr. 491-492)

A review of the Hillsboro expansion numbers not only confirms Staff's discussion, but demonstrates that Staff may have been conservative regarding how efficient other aquifer storage fields operate. A review of the gas requirements for the Hillsboro expansion show that the gas requirements for working inventory accounted for 40 percent of the expansion while, 60 percent was associated with base gas⁶. However, given the poor quality of the Manlove storage reservoir, basically needing 4 units of base gas to support 1 unit of working gas⁷, demonstrates that Peoples Gas claims that

⁶ Forty percent and sixty percent equal 4.5 Bcf/11.5 Bcf and 7.0 Bcf/11.5 Bcf per the order in Docket No. 91-0499, Order dated October 21, 1992, p. 8.

⁷ Manlove historic ratios show 80% base gas to 20% working inventory or a 4 to 1 ratio. (TR 491-492)

no base case or only 1.34 MMDth of base gas is needed to support the expanded storage volume 10.2 Bcf is ludicrous and not only violates basic engineering principles, but also violates common sense.

4. Staff Discussion

Staff demonstrated that its analysis, Peoples Gas statements and various reports indicate the obvious need for base gas. In particular, Peoples Gas' witness Puracchio stated that, "Gas in the Manlove Field reservoir is under pressure and tends to expand, radially invading new areas. As this occurs, some of the gas inevitably becomes trapped as cushion gas." (Peoples Gas Ex. TPL-1.0, p. 10) Staff does not dispute this statement. However, Peoples Gas made this statement to support the continuous need for maintenance or base gas injections into Manlove to maintain field performance over time, not in relation to Hub expansion. Staff's position is that this statement applies for any additional gas injected into Manlove field, including the Hub expansion. (ICC Staff Exhibit 22.0 p. 12 to 13) In other words, as more gas is injected, that gas expands radially into new areas.

Peoples Gas has also indicated that the expansion of working gas without a higher cushion allocation cannot continue indefinitely. (North Shore/Peoples Gas Ex. TLP-2.0, p. 12) Peoples Gas noted that at some point, if growth were to continue, larger quantities of gas would begin to predominantly enter aquifer space not previously occupied by gas and that, when and if that occurs, there will be a need for a much higher cushion gas allocation. However, Peoples Gas just expanded the working inventory at Manlove by 40% to provide Hub services and, as noted previously, Peoples

Gas cannot control where gas expands in the reservoir, the gas just follows the path of least resistance.

The significant and obvious inequity in Peoples Gas' viewpoint that the Manlove storage field expansion for Hub operations requires no base gas or should only be allocated 1.34 MMDth is best demonstrated by the below table that shows the classification of gas in Manlove in 1998 and 1999. The data for 1998 is before the expansion of Manlove to provide Hub services. The data for 1999 is after Peoples Gas initially expanded Manlove by 8 Bcf to perform Hub services (the current Hub capacity allocation is 10.2 Bcf). Classification changes are shown as the percentage of change between 1998 and 1999. (ICC Staff Exhibit 10.0, p. 17)

Table 1

	1998 Before Hub	1999 Hub Expansion	% Change
Natural Gas	Volume	Volume	
Top or Working	27.0 Bcf	35.0 Bcf	30 %
Recoverable Base	4.2 Bcf	4.2 Bcf	0 %
Non-recoverable Base	115.4 Bcf	115.4 Bcf	0 %

The table demonstrates that when Peoples Gas expanded Manlove to provide Hub services, it did not add any recoverable and non-recoverable base gas even though, as discussed above, any additional gas creates an immediate volume of cushion gas. However, it should be noted that Peoples Gas, in 1999, altered the manner, in which it operated Manlove and began making maintenance gas injections of

2% of injected volumes⁸. At that same time, Peoples Gas started charging its PGA customers, but not Hub customers, with maintenance gas costs. Nevertheless, Peoples Gas wants the Commission to believe the working inventory in Manlove can be increased by 30% (the current 10.2 Bcf volume equates to 40%) to provide Hub services without additional injections of base gas. This is just not rational. All working inventory in Manlove, whether for the ratepayer or the Hub, requires base gas to operate. (ICC Staff Exhibit 10.0, pp. 17-18)

Due to Peoples Gas' failure to conduct any studies on the volume of base gas required to support Hub operations, Staff used the historic ratio of inventory gas to base gas prior to the Manlove expansion for Hub operations to provide a rough estimate of the base gas required to support the expanded Hub working inventory. Staff testified that 40 years of operating history at Manlove as well as the operation and theory behind all aquifer storage fields dictate all working inventory requires base gas. (ICC Staff Exhibit 22.0, p. 24) Since the Hub's working inventory is storage and co-mingled in the same geologic formation and under the same conditions as ratepayer gas, those same historic ratio requirements would similarly exist for the Hub. (ICC Staff Exhibit 22.0, p. 21)

Staff's analysis showed that using the historical working inventory to base gas volume that existed prior to the Hub expansion and applying that ratio to the volume of Manlove reserved for Hub operations (10.2 Bcf) indicated about 45.3 Bcf of base gas

⁸ Maintenance gas injections of 2% refer to retaining 2% of all ratepayer injections for base gas. For example, if Peoples Gas injected 100 units for PGA (Purchased Gas Adjustment) customers, only 98 units were available for withdrawal and 2 units went into base gas volumes.

will ultimately be needed to support Hub operations. (ICC Staff Exhibit 10.0, p. 21 to 22)

5. Hub Operations without Base Gas

Staff does not dispute that Peoples Gas has operated the Hub without the addition of a large amount of base gas to support Hub operations. However, the reason for this is that when Peoples Gas started to offer Hub services, it altered the manner it operated the Manlove storage field. This alteration allowed Peoples Gas to not only delay injecting the necessary base gas to support Hub operations, but to also place reliance on Illinois jurisdictional customers to support Hub operations. Unfortunately, changing the operation of the storage field does not alter the need to ultimately add the necessary base gas (an amount Staff estimated would equal 45.3 Bcf). Instead, Staff demonstrated that Peoples Gas' decision to delay the injection of base gas to support Hub operations will ultimately cause the cost of that base gas to dramatically increase versus the cost associated with initially injecting the base gas when the Hub operations began.

Prior to initiating Hub operations, Peoples Gas conducted reservoir studies to determine if it could obtain additional gas volumes from Manlove. These studies indicated it was possible to increase the working inventory from Manlove if Peoples Gas continuously grew the field. (Id., at 28-29) As a result, Peoples Gas faced a choice when it developed the Hub to either inject the necessary base gas immediately into Manlove or to continually inject base gas. Peoples Gas chose to continually inject base gas. Staff does not disagree that Peoples Gas has operated Manlove in this manner, but this decision causes the ultimate cost of the necessary base gas to increase

dramatically. Moreover, the decision to continually inject smaller amounts of base gas instead of injecting all required base gas up front does not change the fact that the periodic base (or maintenance) gas injections are the direct result of Peoples Gas decision to expand its Hub operations.

Peoples Gas' choice to delay the initial injection of the base gas necessary to support Hub operations spreads the cost of that additional base gas out over time, but it also creates a situation where the ultimate cost associated with that base gas will increase. For example, the average system gas cost in 1999, when the Hub expansion began, was \$2.53/Mcf; and using Staff's rough estimate of 45.3 Bcf of additional base gas needed to support the current 10.2 Bcf Hub working inventory results in a base gas cost of \$114,609,000. However, using the 2006 average system cost of \$8.75/Mcf, the cost of 45.3 Bcf of base gas would be \$396,375,000. Obviously, Peoples Gas' decision to not inject base gas when Manlove was first expanded to support the Hub will create a significant cost exposure. Staff's analysis determined that the cost exposure should therefore be borne by the Hub, and not Peoples Gas' ratepayers, for the future injections of base gas necessary to support the Hub operations. (ICC Staff Exhibit 22.0, p. 32) Therefore, it is both equitable and necessary to disallow Peoples Gas requested base gas capitalization

Peoples Gas' decision has also had other impacts. When Peoples Gas initiated Hub operations, it determined Manlove could be operated with only 2% maintenance gas injections. However, Peoples Gas has already greatly increased the percentage of maintenance gas retained by Manlove base gas injections, from 2% to 3.5%. Stated differently, Peoples Gas' failure to initially inject the required base gas created a

situation where the reservoir is attempting to reach its historic equilibrium of 4 units of base gas to one unit of working gas. This base gas shortfall has also created a situation where the reservoir is now demanding a quicker injection of this base gas, creating the need for higher cushion gas allocation due to the Manlove expansion for Hub operations.

6. Rate Payers Already Incurred Base Gas Costs

It should also be noted that when Peoples Gas changed the manner it operated the Manlove storage field, in 1999, Peoples Gas also changed the manner it recovered the cost for its base gas additions by recovering them through the PGA. It was not until the 2001 PGA (Docket No. 01-0707) reconciliation that the Commission directed Peoples Gas to cease that activity. Therefore, from the time Peoples Gas changed its policy (1999) through the day prior to the start of the 2001 PGA reconciliation, Peoples Gas had already passed additional base gas costs associated with the Manlove storage field expansion on to ratepayers through the PGA. Therefore, ratepayers have already incurred the cost for some additional base gas, including gas that rightfully should have been assigned to Hub operations.

Finally, it should be noted that once the Commission directed Peoples Gas to stop recovering maintenance gas costs from ratepayers through the PGA, Peoples Gas only applied the maintenance gas percentage, which is the gas used to continually inject base gas into Manlove, to the gas that Peoples Gas injected for ratepayers. Peoples Gas has never applied a maintenance gas allocation to any Hub operations injections even though the storage field expansion that created the Hub created the increased need for additional base gas injections. For example, Peoples Gas currently

retains 3.5% (up from 2%) of all ratepayer injections into Manlove, but every unit injected into Manlove for the Hub is allowed to be removed. (Tr. 456-457)

The PO fails to state clearly that Hub services are supported by Peoples Gas' entire system and that revenues appropriately flow through the PGA.

While the Final Order in Docket No. 01-0707 was clear that Hub services are supported by Peoples Gas' entire system, including Manlove Field, leased storage services, leased interstate pipeline transportation and flowing gas, the PO is less clear on this point. Further, the PO is not clear that the rates that FERC approves are only maximum rates, and the actual rates that Peoples Gas charges are discounted from the FERC-approved rates. The maximum rates are based upon the costs of the field and the Mahomet Pipeline. Staff accordingly suggests modification to the language of the PO at page 97.

The PO fails to accurately state Staff's position regarding the Hub and misunderstands Staff's cross subsidy argument.

The PO at page 97 misstates Staff's position. Staff does not argue that the Hub is currently costing more than the revenues it brings in, i.e. "the Hub actually loses money". Instead, Staff's position is that Peoples Gas has under-invested in base gas to the extent that there is a high risk that large amounts of expensive base gas are still required in the future. The Hub is seen to be uneconomic by examining costs and benefits over the field's entire life-span.

The Proposed Order at pages 111 to 113 also misunderstands Staff's cross-subsidy argument. Staff notes that Peoples Gas manages Manlove Field on a year-to-year basis. While the Company defends its practices as sufficient to keep the field

operating, the real issue before the Commission is whether this short term approach protects ratepayers from future, large cost increases. Staff's view is that it does not.

If Staff's contention is true, then Hub customers are ultimately cross-subsidized. That is, if over the life of the field the costs of the expansion exceed revenues, then Hub customers are cross-subsidized by ratepayers. Then, the Manlove expansion does not benefit ratepayers.

Staff advocated that all base gas costs be disallowed because neither Staff nor the Company can separate the base gas that is needed to operate the field at previous capacities and the base gas required to support the expansion. Staff did not oppose Peoples Gas' calculations, because they are a simple pro-rating of actual base gas additions, not a true investigation of the base gas required to expand Manlove Field. Since Peoples Gas has under-invested in the field, it cannot be determined with any precision the degree to which base gas additions are due to Hub operations or other Manlove Field operations.

Further, Staff continues to contend that Hub revenues continue to flow through the PGA for the same reasons that it advocated that result in Docket No. 01-0707. By the PGA rules, all revenues from services that use assets whose costs flow through the PGA must flow through the PGA. It was a strong conclusion in that docket that Hub services depended upon the entire system's assets, including assets whose costs were recovered in the PGA. Therefore, regardless of the accounting treatment accorded Hub revenues, they must be used to offset PGA costs. Finally, Staff witness Rearden's name is misspelled throughout the PO. Staff's proposed language corrects for that misspelling.

The PO should reflect the fact that Staff witness Anderson not Dr. Rearden provided Staff's technical engineering expertise on the operation of Manlove storage field.

The PO creates the impression that Dr. Rearden not Staff witness Anderson provided the technical expertise on the engineering of the Manlove storage field. The PO should cite to Staff witness Anderson for technical definitions. To the extent that Dr. Rearden used any technical definitions they were used based upon the reliance of Mr. Anderson's testimony.

The PO fails to take into account the significance of Peoples Gas' failure in the past to determine whether the Hub would benefit ratepayers.

Unlike the PO, the Commission should not ignore the fact that Peoples Gas did not investigate whether beginning the Hub would benefit ratepayers. The Company simply considered whether the expansion was technically feasible. It did not compare the cost of the additional base gas that it might have to purchase to the total expected revenues that the Hub might generate. And it did not consider whether the additional capacity might be more valuable for ratepayers' direct benefit than when used for Hub services. Given that it did not research these issues, ratepayers must be held harmless for the higher rates that they are likely to have to pay.

The PO fails to recognize that the Commission has already ruled that the Hub does not extend Manlove Field's decline point.

The PO reaches the wrong the conclusion that the Hub benefits ratepayers because it extends Manlove Field's decline point which enables the field to perform better. (PO, p. 112) This conclusion is contrary to the Commission's conclusion in

Docket 01-0707. In Docket No. 01-0707, the Commission's Final Order definitively declared that the Hub, in and of itself, does not necessarily 'extend the decline point.' As Staff convincingly pointed out in that docket, how the Hub was operated was more important than the size of the expansion. Staff concedes that the decline point is extended when total inventories increase, all other things equal. However, when Peoples Gas disproportionately withdraws gas for Hub customers, utility service customers are hurt by the decreased ability to withdraw gas later on in the season. Of course, it is possible to operate the field in many different ways, but as shown in Docket No. 01-0707, and specifically in fiscal year 2001, the Hub can certainly shorten the decline point. Over and above the question of whether the Hub necessarily 'extends the decline point' is how much that hypothetical extension is worth. Peoples Gas never provides any estimate for this value. This claim cannot be given credence in this proceeding.

There is no credible evidence to support the position that the Hub lowers gas prices in the Chicago market.

Peoples Gas made a superficial claim that the Hub lowers gas prices in the Chicago market by increasing liquidity which the PO seems to give some credence to (PO, p. 112). That is according to Peoples Gas, by encouraging trades, more gas gets transacted. Peoples Gas alleges that this lowers gas prices. This claim is completely unsupported by logic or empirical evidence in the record. As noted by Staff in its reply brief, while the price signal might become more valuable, the balance of demand and supply determines the price level, not the number of trades. (Staff RB, pp. 39-40) Even if the contention were supported by any information or analysis, Peoples Gas has

declined to estimate the magnitude of the benefit therefore, this alleged benefit of the Hub is not credible.

All of the above indicates that Peoples Gas' alternative approach falls short in allocating the proper amount of base gas requirements to the Hub, and that Staff's recommendation to disallow all of the requested additional cushion gas amounts and related operating and maintenance gas expense is the most appropriate solution. Therefore, Staff recommends the below language changes to the Proposed Order.

However, if the Commission does not accept Staff's exceptions, then Staff suggests alternative recommended language to the PO which would direct Peoples Gas to conduct a reservoir analysis on the Manlove storage field, the purpose of which is to review the base gas needs the Hub operations create within the Manlove reservoir.

Recommended Language

(PO, pp. 97-115)

V. HUB SERVICES (All issues relating to Hub services)

A. Manlove Field

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 the total capacity of its system by displacement. The Hub's maximum rates are based upon the costs of portions of the capacity at Peoples Gas' underground storage facility, Manlove Field, and Mahomet Pipeline. The Federal Energy Regulatory Commission approves the maximum rates that Peoples Gas can charge 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).

Staff takes the position that the Hub actually loses money there is a substantial risk that the cost of the additional base gas that Peoples Gas is likely to have to add to Manlove Field to support provision of Hub services is greater than the Hub revenues, and thus, the Hub is imprudent to operate. As such, Staff would recommend that the Hub be discontinued. City-CUB and the AG do not weigh in on all aspects of the dispute. But, they share a concern and each makes specific recommendations going forward.

The Commission here considers all of the evidence of record and positions taken in the matter.

1. Peoples Gas

Manlove Field, Peoples Gas explains, is an underground aquifer, i.e., porous rock that bears water in the pores. PGL Ex. TLP-1.0, 3:47-55. Its witness observes that Manlove Field is particularly complex, even as aquifer storage fields go. PGL Ex. TLP-1.0, 4:69-84. On the whole, Manlove is large, inefficient (a relatively high percentage of gas becomes trapped), and both difficult to manage and characterize. PGL Ex. TLP-1.0, 3:61-62; Tr. at 472:14-15; 492:3-8. All these features 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 states, it 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, and as expected. PGL Ex. TLP-2.0, 7:156 - 9:193.

Peoples Gas explains that it 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.

2. Staff's Position

Staff takes the position that Peoples Gas should have, but did not inject more base gas at Manlove Field to support the start of Hub operations. The testimony of Staff's witness Reardeen who relied upon Staff witness Anderson's technical expertise for the technical definitions in his testimony defines the essential terms for the issue. He explains that "top gas" (also known as "working gas"), is what is anticipated to be used or cycled in normal operation during the injection or withdrawal season. Staff 12.0. "Recoverable base," according to Mr. Reardeen, is the natural gas that is not normally cycled but which provides pressure in the reservoir to cycle the top gas. *Id.* And, he further defines non-recoverable base gas as what is trapped in the reservoir and cannot be recovered but what is necessary to support the top gas. *Id.* Both of the latter constitute and are interchangeably referred to in testimony as "base", "maintenance," or "cushion" gas.

Staff points out that Peoples Gas increased Manlove Field's working gas inventory by 10.2 BCF in order to be able to provide Hub Services. To increase the Manlove Field working gas, Staff witness Anderson testifies, Peoples Gas needs to inject gas into the field that cannot be withdrawn. Staff Ex. 10.0. He estimates that base gas needed to increase working inventory is approximately four times the amount of the increase in Manlove Field. This base gas becomes part of rate base and since base gas cannot be withdrawn, Staff notes that it is treated as a capital investment by Peoples Gas. Staff Ex. 12.0 Revised at 10-11.

Prior to initiating Hub services, Staff reasons that Peoples Gas had to decide whether to either inject the necessary base gas immediately into Manlove or to continually inject base gas. Staff observes that Peoples Gas has chosen to continually inject base gas. While Staff does not disagree that Peoples Gas can operate Manlove in this manner, its decision causes some concern.

Staff maintains that 40 years of operating history at Manlove as well as the operation and theory behind all aquifer storage fields, dictate that all working inventory requires base gas. Staff Ex. 22.0 at 24. And, it argues, Peoples Gas failed to demonstrate that its expansion of Manlove's working inventory for Hub operations did not also require an expansion in the volume of base gas.

Staff believes that Peoples Gas' choice to delay the initial injection of the base gas necessary to support Hub operations spreads the cost of that additional base gas out over time, but also creates a situation where the ultimate cost associated with that base gas will increase.

On the basis of its gas cost estimates and calculations, Staff argues, Peoples Gas' decision to not inject base gas when Manlove was first expanded to support the Hub will expose it to a significant cost in the future. Staff maintains that the cost exposure should be borne by the Hub and not Peoples Gas' ratepayers for the future injections of base gas necessary to support the Hub operations. Staff Ex. 22.0 at 32.

Staff takes notes of the claim by Peoples Gas to claim that less base gas is needed now than in the past because Manlove Field trapped or retained more initial gas injections than subsequent injections, thus relatively less gas was trapped in more recent injections. (NS/PGL IB, at. 95-96). Staff notes too, that PG provided a graph (North Shore/Peoples Ex. TLP-2.6) that shows a 7-year running average of the additional cushion or base gas added to the field since the field began operation. Staff ~~consideration of~~ points out that this graph shows it to covers a time period with two distinct injection paradigms. From 1964 to 1998, Staff notes, cushion gas was injected only when Manlove performance declined. From 1999 to 2006, however, cushion gas was injected on a continuous basis and recorded as a percentage of volume of the whole-gas injections. As such, Staff observes that Peoples Gas employed different cushion gas injection methodologies in these respective times. But, Staff claims that there is nothing in this information to demonstrate that the maintenance gas needs at Manlove will not increase in the future. (Staff Ex. 22.0 at 29-30). And, Staff submits that Peoples Gas' claim that base gas requirements reduce over time, is disputed by its recent need to increase the base gas continuous injection volumes from 2% to 3.5%.

Staff notes that Peoples Gas to asserts that its recent decision to increase the percentage of gas injections from 2% to 3.5% does not in actuality represent an increase, ~~in that, owing to~~ because there was a metering problem at Manlove caused by pulsations of the compressors (NS/PGL IB, p. 97; NS/PGL Ex. TLP-2.5), Peoples Gas believes that it was likely that it was injecting over 3% instead of the 2% injections it thought ~~to be~~ it was making at the time. In Staff's view, ~~however, the claim of having to increase the percentage of base gas injections from 2% to 3.5% owing to misreading caused by meter error, this~~ is mere speculation and should be treated as such.

Staff rejects the notion that the working inventory in Manlove can be increased by 10.2 Bcf to provide Hub services without any additional injections of base gas. It solidly maintains that all working inventory in Manlove whether for the ratepayer or the Hub requires base gas to operate. (Staff Ex. 10.0, at 17-18) As such, Staff has concerns going forward. Given the lack of studies on the exact volume of base gas required to support Hub operations, Staff created its own analysis and ~~calculated~~ estimated that 45.3 Bcf of base gas was needed to support Hub operations. Recognizing that its methodology provides only a rough estimate in the situation, Staff nevertheless maintains that it shows the obvious disparity between Peoples Gas' claim of zero and the magnitude of the ultimate base gas volumes it believes are needed to support Hub operations. Staff Ex. 10.0 at 21-22.

According to Staff, Peoples Gas never conducted any studies to determine the amount of base gas its Hub operations specifically require. It points out that Peoples Gas' reservoir studies only review the amount of maintenance gas that is continually needed to support the total Manlove

inventory. For example, Staff observes that Peoples Gas' study shows Manlove now needs 3.5% of injected volumes to support Manlove's performance. Ex. TLP 2.1. ~~In Staff's view, believes that this ignores underestimates the need for obviousness of additional base gas, needs and the ultimate cost of that base gas.~~

In Staff's view, Peoples Gas' own evidence indicates an obvious need for base gas. Staff ~~cites notes~~ Peoples Gas' witness Puracchio's to state statement that, "Gas in the Manlove Field reservoir is under pressure and tends to expand, radially invading new areas. As this occurs, some of the gas inevitably becomes trapped as cushion gas." (Peoples Gas Ex. TPL-1.0, p. 10) Staff does not dispute this statement, and observes that this testimony was provided to support the continuous need for maintenance or base gas injections into Manlove in order to maintain field performance over time, not in relation to Hub expansion. Staff's position, however, is that this statement applies for any additional gas injected into Manlove field and including the Hub expansion. Staff Ex. 22.0 at. 12 to 13. In other words, Staff argues, anytime additional gas is injected into Manlove a significant amount of that gas is lost.

Staff refers to Peoples Gas' Ex. TLP-2.1, which it describes as a report that details the information and methodology used to construct a new computer model of Manlove. The result of this study, Staff observes, showed the need to increase the percentage of injections retained as base gas at Manlove from 2% to 3.5%. While Staff does not dispute the need to increase the percentage of injections retained for base gas injection from 2% to 3.5%, it is still concerned that this study could ultimately understate the percentage of injections of cushion gas needed at Manlove.

3. Peoples Gas Response

Peoples Gas asserts that 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 of 1998, it points out, 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, Peoples Gas explains that the expansion of Hub services was much more gradual. PGL Ex. TLP-2.8. Therefore, it was quite reasonable, says Peoples Gas, to continuously inject cushion gas to support all operations at Manlove Field, as opposed to inputting a single large injection.

Over the 40 years Manlove has been in existence, Peoples Gas observes that it has injected a great deal of gas into the field as base gas. This is because 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 began to add base gas going forward at the rate of 3.5%. This operation, Peoples Gas asserts, has proved adequate to keep the field operating properly.

If the situation were that it is injecting too little cushion gas, Peoples Gas asserts that it would notice, and in a relatively short time, that Manlove was not performing properly. Tr. at 485:1-5. In operating an aquifer storage field, Peoples Gas explains, 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. Then, when Peoples Gas increased its injections to approximate their previous levels, field performance promptly returned to normal. PGL Ex. TLP-2.0, 7:136-8:168. Peoples Gas points to this scenario 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 maintains that its capitalized cushion gas injections of 7.88 MMDth have been sufficient.

4. Commission Analysis and Conclusion

With respect to the operations at Manlove Field, and the concerns raised by Staff, the Commission must decide whether Peoples Gas ~~has been~~ is likely to have to making sufficient large additional injections of cushion gas to support its operations. ~~Based on the evidence showing that it has been monitoring Peoples Gas has maintained field performance, with no fall-off in performance since it has been continuously only by increasing the percentage injected toing 3.5%_ cushion gas, w~~ We find that Peoples Gas' faces a substantial risk that it will have to increase cushion gas injections have been reasonable. ~~In total, the~~ While capitalized injections since Peoples Gas' last rate case amount to 7.88 MMDth of gas the Commission agrees with Staff that this represents only a fraction of injections that it will have to make in the future.

Staff is correct that Peoples Gas did not inject new cushion gas to support Hub services at the time it initially began offering those services. At the same time, however, Staff concedes that Peoples Gas could just as well choose to add cushion gas gradually and continuously to support the expanded use of Manlove Field. Staff Init. Br. at 97. ~~In other words, there were two reasonable ways to proceed. The option that Peoples Gas opted chose was to gradually increase its use of Manlove Field for Hub services, while continuing to inject cushion gas annually to support the overall operation of the field rather than determine the required base gas injections.~~ According to the record, ~~this appears to be working. There was only a short period during which cushion gas injections were inadvertently decreased and this caused Peoples Gas to notice a drop in~~

~~field performance. When it increased injections to the correct amounts, however, the field responded quickly and has been operating normally. This performance and the attention to performance is the best evidence. It establishes for the Commission that, in both amount and manner, the While cushion gas injections reported by Peoples Gas so far have been sufficient to maintain field performance, the Commission cannot ignore the risk that Peoples Gas faces that base gas injections cost in the future are likely to outweigh current expected revenues.~~

~~For the purposes of considering Staff's contention that offering Hub services at Manlove 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, to be not reasonable under the entirety of the facts and circumstances borne out by the record.~~

B. Hub Services

1. Peoples Gas

Peoples Gas explains that 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 at 65.

Peoples Gas points out that it 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 points out that it has credited to the Rider 2 Gas Charges,(or will be crediting following an order in its fiscal 2005 cost reconciliation case) over \$20 million in 2005 and 2006 alone, for 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. Peoples Gas would further note that 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.

2. Staff

Staff ~~would have~~ argues that the Commission should order Peoples Gas to cease providing Hub services on account of its belief that because the provision of Hub services at Manlove Field is likely to impose higher costs above revenues upon ratepayers in the coming years. Based on its review, Staff contends that the costs for base gas needed to grow the working inventory gas at Manlove Field are substantial. In this regard, Staff questions the prudence of starting Hub services without a complete analysis and assessment. ~~While Peoples Gas may have examined whether it could expand Manlove Field, but Staff asserts that it never estimated the costs, how long it would take, or whether ratepayers would benefit from the expansion.~~

Staff observes Peoples Gas to assert that there are customer benefits from its provision of Hub Services. And, ~~at the start,~~ Staff concedes that Peoples Gas is crediting revenues that are currently higher than costs currently being incurred. (NS/PGL IB, at 102). Still, it ~~does not believe~~ argues that these revenues are insufficient to justify continued Hub operations, because in Staff's view, the revenues are likely to be overwhelmed by a need for massive investments in base gas. (Staff IB at 86). ~~This is what Staff witness Reardeon's meant, and his net benefit analysis for "revenues greater than costs" included the costs of base gas, that, while not have not been realized as yet to date, but which Staff views as likely to being incurred in the future.~~ (Id. at 31)

Further, Staff disputes Peoples Gas claims that the Hub expansion ~~has extended Manlove's decline curve and that this extension benefits the ratepayer.~~ (Staff Ex. 22.0 at. 34-35) According to Staff, Peoples Gas provides no studies or other documentation to support this statement. Notably too, Peoples Gas made the same claim in Docket 01-0707, which the Commission rejected.

Staff also ~~observes~~ commented on Peoples Gas claim that additional liquidity lowers prices: "[i]ncreasing market liquidity by increasing the supply of gas at the Chicago city gate creates downward pressure on gas prices." (NS/PGL IB, at 100). Staff ~~does not consider~~ argues that this unsubstantiated statement to provides a no compelling reason to allow HUBub services to continue. In Staff's view, the extent to which the Hub adds 'liquidity' to the market is just not clear. Various publications calculated price indices before the Hub was operational, it notes, so a market already existed. Even if the Hub adds some degree of liquidity to the market, Staff does believe that this ~~will~~ necessarily lowers

prices. According to Staff, the best that can be said is that additional liquidity lowers transaction costs, which makes the price signal more valuable. But, in Staff's view, prices themselves are determined by the interaction of supply and demand, and additional liquidity, by itself, does not alter that balance.

Staff states that it is only concerned with whether ratepayers are better off with the Hub or without it, i.e., whether the Hub, including all of its associated costs, is prudent. To this end, Staff conducts a net benefits test. If the result is a negative net benefits (Hub benefits are less than its costs), then ratepayers are subsidizing Hub customers, since ratepayers are covering costs caused by Hub customers. Taking into account Staff's view that Peoples Gas may need to inject up to 36 BCF of base gas Staff calculates that reasonable estimate for the total annual pre-tax cost for base gas is \$11.3 million. (at 24-25). And, Staff observes that Peoples Gas to calculate its historical expenses at approximately \$2.0 million. (Id. at 25) On these factors, Staff witness Rearden estimates that the incremental cost of the Hub Manlove Field expansion in 1998 totals approximately \$13.3 million. (Id. at 26).

Further, in examining the fiscal year Hub revenues over time, Dr. Rearden determined that \$10-\$12 million was a reasonable estimate for Hub revenues. (Id. at 22) He also considered Peoples Gas calculation that \$8.9 million out of \$10.1 million (88%) of total Hub revenues were directly connected to the Manlove expansion. (Ex. TZ 3.6).

~~In another of his tests, Dr. Rearden also tested started whether~~ the Hub is prudent beginning from Today's situation, given with Staff's view about how much base gas Peoples Gas will ultimately have to add to Manlove Field. By Staff's account that totals 45 BCF and since Peoples Gas has already added about 8 BCF, it still is potentially liable for an additional estimated 37.4 BCF. This amount calculates at total annual costs of approximately \$16 million. Under this scenario, and owing to Peoples Gas claims that revenues are likely to run to less than \$12 million, Staff maintains that the Hub cannot hold ratepayers harmless. Even at that, Staff observes the \$4 gas cost to be at the low end of what is reasonable in today's gas market. At higher gas prices, like the \$6 and \$8 levels that Dr. Rearden considered for his study, the cost to inject base gas into Manlove Field increases and suggests that the Hub is unlikely will be able to pay for itself going forward. Under all the variables used for his study, Staff argues, Dr. Rearden concluded that the Hub is uneconomic for ratepayers. Staff Ex. 24.0 (Corrected) at 27.

Staff claims that, before Peoples Gas expanded Manlove Field, it did not examine the value that the extra capacity might provide to ratepayers as a physical hedge and for peak day deliverability. Rather than using the system to generate Hub revenues, Staff believes that the system could be used to decrease ratepayers' gas costs. In Staff's view, increasing Manlove Field's assignment allocation to ratepayers might enable the

Peoples Gas to substitute Manlove Field storage for leased storage and/or transportation services. (Staff Ex. 24.0 Corrected, at 29).

Staff notes that, in surrebuttal testimony, Peoples Gas did present a study that purported to investigate whether the additional capacity (10.2 MMDth) benefitted ratepayers more by using it to offer Hub services or to physically hedge gas for ratepayers. Staff observes this study to reflect Peoples Gas estimate that the physical hedge is worth \$9.3m, while it forecasts Hub storage revenues (those resulting from the expanded Manlove Field) equal to \$10m. In addition, there is the position that, if the 10.2 MMDth additional capacity in Manlove Field can be used to store gas for ratepayers, Peoples Gas must earn a return on the expenditures for the increased gas volumes. (North Shore/Peoples Gas Ex. TEZ-3.0 at 40)

While the figures derived from the two options are roughly of the same magnitude, Staff does believe them to be directly comparable. According to Staff, revenues of \$10 million does not correspond to the total value of Hub storage services to Hub customers, but represents some fraction (not determined, since it is a function of the market) of the value of the physical hedge. In other words, Staff maintains, the physical hedge value is likely to be split between the customer and Peoples Gas as the Hub services provider. In Staff's view, either the \$9.3 million amount underestimates the physical hedge, or the Hub revenues of \$10 million is not a realistic amount or tied to other years with a different seasonal price differential.

Referring back to the tests it produced, Staff claims to have demonstrated that costs are higher than revenues, and that the revenue shortfall from Hub services will be ultimately borne by ratepayers. As such, Staff argues, Peoples Gas should cease Hub transactions. (Id.at 34-35).

Staff notes that CUB-City's main point about the Hub appears to be that Peoples Gas should stop their practice of predetermining a portion of Manlove storage capacity to be used for the Hub before it optimizes its gas supply portfolio. (CUB-City IB, at 54) Staff agrees that the Manlove Field's working inventory should not be allocated for Hub Services before determining the optimal allocation to ratepayers. But, in the event that the Commission does bring about a discontinuation of

Staff further believes that the total of 7.88 MMDth volume of base gas, valued at \$39,019,000 should be denied rate base treatment. In addition, Staff recommends that Peoples Gas' reported HUB expenses should also be disallowed from rates. In Staff's view, these are not shown to be just and reasonable.

Were the Commission to not find any imprudence in the expansion of Manlove Field, Staff claims that the cost associated therewith should still fail recovery. This is so, Staff argues, because Peoples Gas did not obtain prior Commission approval for its actions as required under Section 7-102 (E) of the PUA. 220 ILCS 5/7-102(A)(g). Staff claims that a number

of legal opinions support its position on the matter. (Staff Initial Br. at 64-70)

3. City-CUB

* * *

4. Peoples Gas' Response

* * *

5. Commission Analysis and Conclusion

On the whole of the record before us, and on this date, the Commission ~~agrees is unable to find that the expansion of Manlove Field was~~ imprudent. We ~~note that the expansion began without a formal analysis of whether the field should be expanded, and Peoples Gas has still not developed a long range plan for managing the field.~~ have already considered that While Peoples Gas has apparently been injecting base gas in amounts sufficient to support Manlove Field's operation to date, and this includes storage for sales customers, services to its transportation customers and FERC jurisdictional Hub operations. There is no evidence to persuade us otherwise. Peoples Gas has not considered the risk that it will be required to greatly increase those amounts in the future.

~~Staff's derives its position that Hub services are imprudent and its conclusions in the matter are based upon what derives from its net benefits test based upon sound engineering expertise. While we understand that sSuch an analysis is useful and telling, we also believe that it must be conducted properly and fairly. All tThe tests Staff relies upon we see here begin with the same faulty premise, i.e., the unproven fact the idea that expanding Manlove Field cannot be accomplished without capital expenditures. It is an established fact in this record that base gas is required to expand Manlove Field. The point of controversy is how much gas is likely to be required in the long run. Staff's rough estimate is that Manlove Field needed (in 1998), or needs today, 45 bcf of additional base gas to support a 10.2 BCF increase in field capacity. In On the other handwords, Staff's arguments as well as the inputs for its calculations rely on pure speculation that massive amounts of base gas into Manlove will be needed in the future. We cannot accept that assumption, however, because the evidence today does not reveal this to be fact. So all we have for the net benefits analysis are a series of sterile mathematical calculations neither grounded in observation of performance~~

~~nor aided by the requisite scientific expertise. This type of analysis will not serve us in these premises and must be rejected. Peoples Gas argues that the increase in capacity can continue while it merely injects some small percentage of gas into base gas. Staff's view is more reasonable and the Commission is not aware of any other aquifer behaving in the way that People Gas suggests.~~

~~The bottom line, is that we do not find the imprudence on which Staff hinges its position.~~

~~Considering all of the relevant evidence at hand, the Commission is persuaded We note that, at this time, the Hub's costs are provides more benefits than costs exceeding its cash outlays. We come to this conclusion by examining all of the relevant evidence. The record shows that Hub revenues have exceeded \$10 million annually and they are expected to exceed that amount in 2007. NS/PGL Ex. TZ-2.0, 70:1547-1551. It is uncontested that, pursuant to the Commission' Order in Docket 01-0707, And all revenues from Hub services are credited to Peoples Gas' customers through reductions its Rider 2 Gas Charges, including a gross \$20 million in 2005 and 2006 and a forecasted gross \$13 million in 2007. (NS/PGL Init. Br. at 99). And, But, the Commission is compelled by the record to find that Peoples Gas has and is complying with our order by crediting to Rider 2 gross revenues from the Hub still risks incurring large costs in the future to shore up its base gas at Manlove Field. In light of this very real monetary benefitrisk, the Commission believes that it would be harmfuls to customers to allow Peoples Gas to eliminate continue to operate the Hub.~~

~~Peoples Gas also asserts Other evidence leads the Commission to conclude that the Hub benefits Peoples Gas' customers in a less direct but equally meaningful other ways. As such, Peoples Gas argues informs that additional Hub field volumes injected for Hub customers serve to extend the decline point at Manlove Field and raising the this enables the field's to performance better. While Staff claims notes that this attribute is not supported, since how the Hub is run determines its effect on the decline point. For example, if Hub customers are granted priority in withdrawing gas from Manlove Field, then the decline point may actually be earlier than it otherwise would. we find that independent studies of record, i.e., the Roxar Inc. report of 1999 and the Connaughton Reports of 2003 and 2005, have not been challenged, and these indicate an extension of the decline point. On this evidence, the Commission is persuaded that the extension of the Manlove Field decline point is a benefit of HUB and this benefit is extends to all customers of Peoples Gas. This is the argument that was demonstrated in Docket 01-0707, when the Commission found this argument unpersuasive and rejected it. Finally, in neither Docket No. 01-0707 nor in this docket has the Company provided a credible estimate for the value that a potential decline point extension is worth.~~

~~The Commission also considers the Peoples Gas' assertion that the Hub activity 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. While Staff disagrees, and notes that both of these arguments are of second order of magnitude in any case, and so do not overcome the direct examination of the Hub's prudence, the evidence does suggest there being some likelihood of downward pressure created because of Hub activity and from this we gather there is benefit to all customers.

~~The Commission also observes that under a proper allocation of the cost of the base gas supporting Hub operations, the Hub's revenues easily exceed costs. NS/PGL Ex. TZ 2.07. We are mindful that the cost of base gas is shared by Hub customers, but all of the revenues are being credited to the customers through the Purchased Gas Adjustment. NS/PGL Ex. TZ 2.0, 68:1520-1524. Staff would minimize this tangible benefit that even all of the GCI parties acknowledge to exist.~~

~~There is not, nor can there be, any concern of Gas Charge assets being used to subsidize Hub services. The record makes clear and it is unchallenged that 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. NS/PGL Ex. TZ 2.0, 69:1538-1540. The Commission finds the record devoid of any evidence that Peoples Gas has utilized any of the Gas Charge assets to subsidize Hub services. We observe too, that the storage expansion for the Hub began years after Peoples Gas' last rate case. As such, the base rates approved in Peoples Gas' last rate case proceeding, i.e., Docket 95-0032 reflected a test year that preceded the expansion of Manlove Field.~~

Staff recommends that the base gas cost of \$39,018,791.41 that Peoples Gas is proposing be wholly disallowed. In addition, Staff recommends that the Utility's reported Hub expenses of \$2,533,000 also be disallowed. In other words, Staff would assign all revenues to ratepayers and none of the reasonable costs incurred. Staff's recommendation is reasonable and supported by the law. Given that the PUA requires Peoples Gas to seek approval from the Commission to set up the Hub, the failure on Peoples Gas' part to obtain that approval results in certain negative consequences for Peoples Gas which are called for by the law, in particular Section 7-102(E). The basis for this conclusion is as follows. We agree with Staff that pursuant to Section 7-102(A)(g) Peoples Gas was required to obtain approval from the Commission before establishing the Hub. Under Section 7-102(A)(g) the test to determine whether Peoples Gas' setting up the Hub required Commission approval is to determine whether the Hub is or is not "essentially and directly connected with or a proper and necessary department or division of the business of such public utility." (220 ILCS 5/7-102(A)(g) At the evidentiary hearings during cross examination by the Administrative Law Judge,

Peoples Gas' witness admitted that Hub services are not necessary for Peoples Gas' utility business. The evidence further establishes that Hub services could be phased out over time with no indication of any negative impact on services to ratepayers. Given these facts the Commission agrees with Staff that the Hub is not essentially and directly connected with or a proper and necessary department or division of the business of Peoples Gas. There is no dispute that Peoples Gas never filed a petition under Section 7-102(A)(g) seeking approval from the Commission. Given that failure on the part of Peoples Gas pursuant to Section 7-102(E) the transaction setting up the Hub are void. Given that those transactions are void consistent with prior case law, the Commission cannot allow Peoples Gas to recover its Hub expenses of \$2,533,000 through rates nor allow Peoples Gas to include in rate base gas costs of \$39,018,791.41 attributable to the Hub. If in the future Peoples Gas desires to recover gas costs in rate base it would need to file a petition under Section 7-102(A)(g). At that point in time the Commission would determine whether the public would be convenience by granting such a petition. Finally, while the Hub was the subject of Docket No. 01-0707 are order in that docket did not amount to a waiver of the requirements of Section 7-102(E) given that the issue in Docket 01-0707 was the impact of the Hub on the 2001 PGA docket and not whether establishment of the Hub would serve the public convenience an issue which has an impact on ratepayers beyond the 2001 PGA year.~~We are not comfortable with this one-sided view. So too, Staff's proposed disallowance lacks clarity and conviction. In large part, the premise of Staff's entire argument is that Peoples Gas *has not injected enough base gas* in Manlove. At the same time, however, Staff's proposed disallowance would have Peoples Gas not put *any* base gas into rate base. There is a fundamental inconsistency here that cannot be reconciled. It amounts to overreaching.~~

~~Recognizing that the Commission might not find imprudence in the decision to expand Manlove Field for Hub services, Staff argues that PG's failure to apply for Section 7-102 (A)(g) should result in the denial of cost recovery. We do not agree.~~

~~The Commission seriously questions that Peoples Gas was required to acquire prior approval to expand working gas at Manlove Field. As we read Section 7-102(A)(g) of the Act, 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. This statute 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". Based on what is on record, that is not the situation here.~~

~~We need not bother with a full statutory construction because there is more at hand and it is of dispositive legal significance. Staff fails to recognize that the Commission took close consideration of Peoples Gas' Hub services in Docket 01-0707. In that proceeding, we issued certain directives to the Utility as to the proper accounting for the costs and revenues. By our actions, the Commission has effectively provided approval and both we and People Gas are bound to that Order in Docket 01-0707. Considered in still another way, our actions amount to a waiver of approval as is also within the authority that Section 7-102 (A) provides.~~

~~We observe that during fiscal years 1997 through 2006, Peoples Gas capitalized an additional 7.88 MMDth of injections as cushion gas into Manlove Field, at a cost of \$39,019,000, which it now proposes to include in rate base. *Id.* at 11. We further note that Peoples Gas has estimated that the amount of cushion gas attributable to Hub services is 1.34MMDth. In the final analysis, the Commission concludes that \$34,857,000 will be included in rate base together with \$2,533,000 of operations and maintenance expense. In conclusion Peoples Gas proposed to add \$39,019,000 to base gas, to which it now wants to include in rate base. *Id.* at 11. In the final analysis, the Commission denies recovery of any increase in rate base together with \$2,533,000 of operations and maintenance expense. Staff also recommends that the Hub be discontinued. While the Commission would expect that Peoples Gas would discontinue the Hub upon being denied recovery of its costs while revenues flow through the PGA, the Commission directs Peoples Gas to cease operating the Hub for the reasons set forth above.~~

C. Hub Procedures - Manlove Capacity Standards

1. Staff

Staff raised a concern that Peoples Gas had increased its leased storage capacity volumes while at the same time reducing its own allocation of Manlove storage capacity in favor of the Hub. (Ex. 23.0 at 14). On the basis of this account, Staff recommended that Peoples Gas develop procedures to document how it allocates capacity from the Manlove storage field and how it ensures that rate payers are not harmed by its decision. (*Id.*) Staff further 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.*)

2. Peoples Gas

Peoples Gas agreed to Staff's proposal, but it requested 120 days instead of the 60 days recommended by Staff. (NS/PGL Ex. TEZ-3.0 at 38) It notes that this date change is acceptable to Staff. Thus, Peoples Gas observes, it is uncontested that it will provide to the Director of the Energy Division within 120 days of the Commission's Final Order in this

proceeding, procedures to document how it allocates capacity from the Manlove storage field and how it ensures that rate payers are not harmed by its decision.

3. City-CUB

In their joint brief, City-CUB note with particularity the testimony of Peoples Gas witness Zack and his statement that the Utility plans to conduct analyses with regard to determining the most economic use of Manlove storage and the Hub for the benefit of ratepayers. They further point to Mr. Zack's claim that the gas dispatch model would be made part of this analysis. *Id.* at 541. These parties explain to the Commission that if Peoples Gas were directed and required to conduct the analyses described by Mr. Zack, i.e., using the gas dispatch model to optimize use of Manlove field on behalf of its sales customers, City-CUB's concerns about the appropriate use of the storage field would be resolved.

4. AG Position

The AG recognizes that while the Commission typically does not dictate the precise way in which utility assets are to be utilized, some involvement appears to be required in this situation. In particular, the AG observes City and CUB to have identified that use of Manlove Field as a way to reduce gas costs for ratepayers has never been sufficiently analyzed. At the heart of the AG's proposal is to have Peoples Gas explore the possibility of devoting the entirety of Manlove field to sales customer service; or using some capacity for sales customers while also reducing leased storage; or using some Hub capacity for sales customers without reducing leased storage. According to the AG, these are the same concepts that the City and CUB support. In addition, the AG would have the Utility consider whether the gas dispatch model or another mechanism will better optimize ratepayer interests.

Further, the AG asserts, that Peoples Gas should continue to account for all Hub revenues and non-tariff revenues in accordance with the Commission's order in Docket 01-0707, and in compliance with 83 Ill. Admin Code 525.40(d), unless and until ordered to do otherwise by the Commission.

5. Commission Analysis and Conclusion

Given the Commission's decision that Peoples Gas cease operating the Hub the Commission need not address Staff's recommendation that Peoples Gas develop procedures to document how it allocates capacity from the Manlove storage field and how it ensures that rate payers are not harmed by its decision. ~~Based on the~~

~~recommendations of Staff, the Commission orders Peoples Gas to submit to the Director of the Energy Division, a report of procedures to document how Peoples Gas allocates Manlove storage capacity and how it ensures that ratepayers are not harmed by its allocation decisions.~~

~~Everything that is set out by the City CUB and the AG tells us that Staff's proposal is reasonable and necessary to satisfy all of the GCI parties' concerns in these premises. As agreed to between Staff and Peoples Gas, this document will be submitted by the Utility no later than 120 days from the date of the Commission's final order in this proceeding.~~

~~After Staff completes its review, it will inform the Commission further.~~

Alternative Recommended Language

(PO, p. 113)

We observe that during fiscal years 1997 through 2006, Peoples Gas capitalized an additional 7.88 MMDth of injections as cushion gas into Manlove Field, at a cost of \$39,019,000, which it now proposes to include in rate base. *Id.* at 11. We further note that Peoples Gas has estimated that the amount of cushion gas attributable to Hub services is 1.34MMDth. In the final analysis, the Commission concludes that \$34,857,000 will be included in rate base together with \$2,533,000 of operations and maintenance expense.

Given the widely disparate positions the parties have taken regarding the ultimate base gas needs of the Manlove storage field due to the Hub operations, and Staff's concern regarding the potential for a large and costly volume of additional base gas needed to support Hub operations, the Commission directs Peoples Gas to work with the Commission Staff to determine the scope of a reservoir analysis to be conducted on the Manlove storage field whose purpose is to review and determine the ultimate increase in base gas needs the Hub operations create within the reservoir and not just the minimum amount that Peoples Gas determines is needed each year. The scope for this study should be determined within 120 days of date of this order and the study should be initiated as soon as possible after the scope of the review is determined using an entity not affiliated with Peoples Gas and who is also acceptable to the Commission Staff.

VI. WEATHER NORMALIZATION – AVERAGING PERIOD

While Staff did not advocate for either a ten or thirty year time period in this docket, it notes that the PO recommends a twelve year period. Staff notes that the only

change for weather normalization periods was in the recent Nicor case, to ten years. (In re Northern Illinois Gas Co., ICC Docket No. 04-0779, Order, p. 56, Sept. 20, 2005) Staff believes that, if the period is to be changed from thirty years, it will be helpful for Staff and the Commission to have consistency in adopting the ten year period proposed by the Companies. Otherwise, multiple periods for the multiple companies the Commission regulates could develop, producing inconsistencies not intended. Moreover, multiple periods could also encourage companies to engage in period shopping to obtain a more profit-maximizing weather normalization period. Therefore, Staff recommends the following language changes to the PO:

Recommended Language

(PO, p. 119)

Commission Analysis and Conclusion

~~The Commission does not agree, however, that the Utilities' 10-year data set is the optimal choice for rate-setting. While the Utilities' rationales for selecting that time frame ("rounding" and consistency with Nicor) do not make up for the greater predictive accuracy apparently associated with 8- and 12-year data, the Commission agrees that consistency across Illinois utilities is important and will avoid unintended consequences and discourage "period-shopping". Therefore, the Commission approves weather normalization based on 102 years of data, which we prefer to the 8-year interval because 12 years will include both the atypically cold weather of 1996 and the warmest weather of 1998. PGL NS Marozas Ex. 1.0 at 6. The Commission cannot know how long the rates established here will remain in effect, but we do know that the Utilities' current rates have prevailed for 12 years.~~

Additionally, we will require the Utilities to use the most recent 102 years, including 2007. The Utilities have demonstrated that northern Illinois' climate is trending incrementally warmer. Consequently, the most relevant 102-year data will presumably be the most recent.

VII. NEW RIDERS

A. Overview

1. Rider VBA

The Proposed Order provides a well written summary of the parties' positions and correctly rejects the Rider VBA proposal made by Peoples Gas and North Shore. (PO, pp. 119-133) While Staff supports and concurs with the Proposed Order's conclusion in this regard, Staff urges the ALJs and the Commission to reconsider the decision to "pass" on the legal issues. (See PO, p. 132) Staff established in its Initial Brief and Reply Brief that Rider VBA violates the prohibitions against retroactive and single issue ratemaking. Staff and other parties have invested considerable effort in addressing these legal issues and related facts, and Staff can discern no compelling reason to defer addressing these issues. Staff provides recommended replacement language below.

Staff also proposes some minor clarifications to the summary of its position. In some cases, Staff's presentation in its briefs was not as clearly presented as it should have been, These edits do not change the substance of Staff's position, but rather clarify the meaning and intent of Staff's arguments and correct several typographical errors. In one case, Staff's arguments in its reply brief are important to a full understanding of Staff's position, and those arguments are added.

Recommended Language:

(PO, pp. 120-124)

b) Staff

Staff opposes Rider VBA on grounds that it violates several legal principles applicable to the development of rates; does not meet the legal burden necessary to warrant special rider treatment; adds additional

regulatory overview to an already burdened system; and, unnecessarily supplements the Utilities earnings at the expense of the ratepayers, when the Utilities already have ample opportunity to achieve their authorized rate of return. For these reasons, Staff urges the Commission to reject Rider VBA.

* * *

Staff's view of Rider VBA is that it seeks to ensure recovery of 100% of the revenue requirement ~~related to be recovered through the volumetric component of rates charges~~ irrespective of any actual reduction in demand. While the volumetric charges are designed to recover some costs that are fixed, these also recover variable costs. According to Ms. Grace, about 5% of Peoples Gas' costs and 1% of North Shore's costs vary with throughput. North Shore Ex. VG-1.0 REV at 6; Peoples Gas Ex. VG-1.0 2REV at 8. While these percentages are not high, Staff asserts ~~claims~~ that Rider VBA does not produce just and reasonable rates because fails to take into account these variable costs, and it provides for recovery of variable costs that are not incurred or reduced ~~in~~ if customers reduce demand.

* * *

While the Utilities posit that Rider VBA is needed to give them the proper incentives to implement energy efficiency measures, Staff points out that the Commission has not been given the authority under the PUA to adopt incentive based regulation (Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 203 Ill. App. 3d 424 (2nd Dist. 1990)), and adopting a rider to provide for incentive based regulation is improper (A. Finkl & Sons Co. v. Illinois Commerce Comm'n, 250 Ill. App. 3d 317 (1st Dist. 1993)).

Staff also notes that in 1997, following the decisions in *Bell* and *Finkl*, the Illinois legislature passed into law Public Act 90-561, which rewrote Section 9-244 of the PUA to authorize the Commission to implement alternative incentive-based rate regulation in certain well defined circumstances. (See 220 ILCS 5/9-244) Staff notes that the Utilities have not asserted at any time in this proceeding that Rider VBA or Rider WNA are proposed pursuant to Section 9-244, and such riders do not fit within the specific authority provided therein for alternative incentive-based rate regulation. Moreover, Staff maintains that the holdings in *Bell* and *Finkl* that the Commission lacks general authority to implement incentive-based regulation and may not rely on the provision of incentives to justify rider recovery continue to apply -- notwithstanding the specific incentive-based alternative rate regulation authorized by the amendment of Section 9-244 -- under the well established principle of statutory construction that "an amendatory act is to be interpreted as continuing in effect (as previously judicially construed) the unchanged

portions thereof.” (People v. Laboud, ,122 Ill. 2d 50, 55 (1988); see also Union Electric Co. v. Illinois Commerce Comm’n, 77 Ill. 2d 364, 380 (1979) (“It is well established that the reenactment of a statute which has been judicially construed is in effect an adoption of that construction by the legislature unless a contrary intent appears.”)) Staff argues that Section 9-244 provides authority to implement alternative incentive-based rate regulation in specific limited circumstances, but nowhere indicates an intent to establish that the Commission has a general authority to implement incentive-based regulation.

* * *

Recommended Language

(PO, pp. 132-133)

f) Commission Analysis and Conclusion

This case presents the Commission with its first introduction to decoupling mechanisms and it is being presented here with proposed Rider VBA. In simplest form, Rider VBA would adjust customer prices under Service Classifications Nos. 1N, 1H, and 2, and in a way that the Utilities revenues are held constant despite changes in customer consumption. Such changes in consumption are brought about by rising natural gas prices, the call for conservation measures, warming weather trends, the involvement of the Utilities in gas efficiency programs, and other events. ~~These~~ proposed monthly adjustments under Rider VBA ~~between rate cases~~ are symmetrical meaning that they are based on both the over-recovery as well as the under-recovery of target revenues. Implementing Rider VBA imposes some additional administrative expenses and, among other things called for by Staff, there would be annual internal audits.

The question raised by Staff and the GCI parties is whether Rider VBA is legal, i.e., whether it is the type of mechanism that the Commission has authority to adopt. We note that the use of riders is appropriate to address the burden imposed by ~~when there are costs at issue and these are either that are unexpected, or volatile or and fluctuating.~~ We agree with Staff, that Rider VBA is fundamentally different from any other rider that the Commission has authorized thus far and which the courts have approved. At the very outset, the subject is revenues and not costs. And, the only instance where revenue recovery was at issue, the Court struck down the rider. A. Finkl & Sons Co. v. Illinois Commerce Comm’n, 250 Ill. App. 3d 317 (1st Dist. 1993). ~~But the facts and circumstances there were of a much different nature and require a different analysis. In any event,~~

~~we pass the question and move to matters that drive our decision in the matter.~~

Illinois case law clearly establishes that the PUA “prohibits refunds when rates are too high and surcharges when rates are too low.” *Business & Professional People for the Public Interest v. Illinois Commerce Comm’n.*, 136 Ill. 2d 192, 209 (1989). Once the Commission has determined a rate to be just and reasonable and put it into effect, it can not later determine the rate was excessive. *Business & Professional People for Public Interest v. Illinois Commerce Comm’n.*, 171 Ill. App. 3d 948, 958 (1st Dist. 1988). The recovery mechanism under Rider VBA is designed to provide refunds or surcharges based on an assessment of whether the rates approved by the Commission in a base rate proceeding turn out to be too low or too high based on the actual demand that subsequently develops. This is a unique feature of Rider VBA which clearly distinguishes it from riders for the recovery of certain expenses that we have previously approved and the court’s have upheld. We agree with Staff and the GCI parties that the proposal before us constitutes impermissible retroactive ratemaking.

As previously discussed, the rule against single-issue ratemaking is based on the principle that the Commission sets rates based on aggregate costs and demands. In *Business & Professional People for the Public Interest v. Illinois Commerce Comm’n.*, 146 Ill. 2d 175, 244-45 (1991), the Illinois Supreme Court explained that the rule would be violated by consideration of changes in demand without considering changes in expenses, and vice versa. While proposed Rider VBA contains an adjustment mechanism that operates in a symmetrical manner with respect to changes in demand, those adjustments do not take into account other changes in the revenue requirement formula or earnings. Thus, in this regard, Rider VBA also runs afoul of the prohibition against single issue ratemaking.

Even if Rider VBA did not violate the prohibitions against retroactive and single issue ratemaking, we would decline use our discretionary authority to approve rider recovery with respect to Rider VBA. We observe the Utilities to contend that decoupling mechanisms, like Rider VBA, are being implemented by state commission across the country

* * *

We do not minimize the Utilities business challenges in this term of high gas prices and the various responses being undertaken. In our view, however, and on the record, the urgency to act on a decoupling mechanism such as Rider VBA proposal is not yet upon us. The Utilities are in the midst of a rate case that should bring about significant effects through rate design and weather normalization changes. Considered

another way, neither the Utilities nor this Commission know the actual results of the changes that we are implementing today. Another possible change that weighs heavily on the Commission in this case, is the proposal for an energy efficiency plan. While the AG and City-CUB make not much of effort or the amounts involved, we view this proposal as ground-breaking and in the best possible way.

~~Energy efficiency is an underutilized resource. All market participants, including the Utilities need to be part of a concerted effort to change the status quo. And, in the process, the current regulatory structure may also have to be re-examined and better tuned to accept new realities and objectives. As such, we do not discount the decoupling mechanism altogether. It would be unwise and foolhardy to do so in this proceeding. It may well prove that a mechanism of this type and infused with properly structured safeguards may ultimately fulfill regulatory objectives in better way. But, at this time and in these premises, Rider VBA is not that proposal.~~

~~In time, the Commission will need to see a full, reasoned and studied analysis both as to the benefits and the potential for harm that accompany a decoupling mechanism such as Rider VBA. We will further need to have all of the parties better understand the mechanism and to debate freely the various aspects that might have make such a mechanism viable. Ultimately, what the Commission seeks, is a more consensus-oriented proposal.~~

~~In our view too, the better way is for the General Assembly to provide us with direct authority for examination of these and other mechanisms. In light of the State's rising concern for energy efficiency and conservation measures, we believe it equally important that this Commission be given the express authority to consider new regulatory mechanisms that correspond to these initiatives.~~

~~If we are not prepared to approve Rider VBA today, the Commission is still better informed for the future.~~

2. Rider WNA

Like Rider VBA, the Proposed Order does not reach any legal issues associated with Rider WNA. As explained in Staff's Initial Brief and Reply Brief, Rider WNA attempts to ensure the recovery of revenues in a manner similar to Rider VBA – only the adjustment mechanism is limited to revenue impacts caused by variations in weather instead of all variations in demand. Thus, Rider WNA suffers from the same

legal deficiencies as Rider VBA regarding retroactive ratemaking and single issues.

Thus, Staff recommends, as it did for Rider VBA, that the Proposed Order be modified to reject Rider WNA on these same legal grounds.

Recommended Language

(PO, p. 140)

The Commission has not found it reasonable or appropriate to approve proposed Rider VBA. And, we here conclude in the same way with respect to the alternative proposal of Rider WNA. With respect to the prohibitions against retroactive and single issue ratemaking, we note that Rider WNA attempts to ensure the recovery of revenues in a manner similar to Rider VBA – only the adjustment mechanism is limited to revenue impacts caused by variations in weather instead of all variations in demand. The limitation in the amount of adjustment to occur under Rider WNA relative to Rider VBA does not remove the features of Rider VBA that we found to violate the prohibitions against retroactive and single issue ratemaking. Thus, for the reasons that we found Rider VBA to violate the prohibitions against retroactive and single issue ratemaking, and we reach the same result here for Rider WNA.

Moreover, even if Rider WNA was not improper as a matter of law and was within our discretionary authority to approve, we would decline to exercise our discretionary authority under the present circumstances. While weather can have an impact on demand, we agree with Staff and the GCI parties that the Utilities have not demonstrated a need for Rider WNA sufficient for the Commission to exercise its discretionary authority to allow rider recovery. The record evidence establishes the Utilities ability to operate successfully within the confines of the traditional regulatory paradigm. They have been able to avoid filing a new rate case for a full 12 years and have earned rates of return at or above their authorized levels for a number of years within this period. To be sure, Staff and the Interveners appear somewhat less critical of Rider WNA. Nevertheless, this mechanism needed their active support. In something this new, we need to know not only what is wrong, but what can be corrected or modified to make the mechanism work properly for both the Utilities and the ratepayers. There is no evidence of this type on record.

We recognize that variations from normal weather will have an effect on the revenues arising from rates established in this proceeding. Indeed, in another part of this Order dealing with Gas in Storage we observed that weather played a critical role. We recognize too, that when a utility sells less gas, it recovers a smaller portion of its fixed costs. Additionally, there ~~There are, however,~~ some changes being brought

about in this proceeding ~~that may~~ and it is too soon to tell if these will not lessen the Utilities' climate challenges. ~~We recognize too, that mechanisms such as the Utilities' proposed Rider WNA have some merit and have gained acceptance in other jurisdictions. But, where this proposal has not been developed in a way to foster support and understanding among all of the parties, it essentially leaves the Commission unable to meaningfully assess all of the benefits and pitfalls of taking such a novel step.~~ At this time, and in these premises, the Commission rejects Rider WNA.

C. Rider EEP (Merits of Energy Efficiency Program and Rate Treatment)

Merits of Energy Efficiency

Staff takes issue with the PO's conclusion that approval of the EEP as presented in this consolidated docket is "consistent with the policy goals contained in the Public Utilities Act" (PO, p. 169) The PO specifically cites the goals of providing "...adequate, efficient, reliable, environmentally safe and least-cost public utility services..." (220 ILCS 5/1-102) It is significant to note that even the PO does not take the position that the PUA mandates EEP. This means that the Commission must decide the issue based only upon whether the programs make ratepayers better off; i.e., whether the programs result in efficient and least cost public utility service for rate payers. The facts in this record do not support that conclusion. As Staff witness Rearden testified to and Staff pointed out in its initial brief no specific EEP initiatives are provided by the Companies. The Companies discussed types of programs and technologies that could be implemented, but the initiatives are left to the Governance Board after it has been constituted. (Staff IB, pp. 202-203; ICC Staff Exhibit 12.0 Revised, p. 32) As a result the Companies cannot guarantee to the Commission that the pledges made by the Companies will necessarily translate in to prudent expenditures (Staff IB, p. 203) which in turn means that it has not been demonstrated in the record that least cost service will result from the EEP. The EEP has also not been shown to result in least cost service

given that the Companies failed to present a base case for conservation spending that would occur absent the EEP. Without establishing a base case, it is not possible to measure the incremental effect of EEP, which also represents a failure to demonstrate that least cost service results from adoption of the EEP. (Staff IB, p. 204)

Some customers are better off with the program, but others are clearly not. The Commission must then decide that it is acceptable to charge one group of customers to benefit another. That is, the Commission must decide that the benefits for one group outweigh the cost to the other. (Staff IB, pp. 203-204) If there were aggregate benefits that accrued to all customers, then this tradeoff may be easier or even avoided. However, the evidence supporting 'system-wide' benefits is not convincing. Various parties claimed that adopting EEP lowers energy consumption which in turn lowers gas prices. Staff disagrees with that assumption given that the minimal effect that EEP can have on the Chicago citygate is nil, since gas is priced in a national market. The size of the proposed EEP program relative to the national gas market is an infinitesimal percentage of the total market demand in the United States and the effect of even a very successfully EEP could have on the market demand would be even smaller. (Staff IB, p. 208)

Based upon the above the Commission should reject the PO's conclusion that the Companies' EEP have been shown to be consistent with the policy goals of the PUA. Staff recommends the following language changes.

Recommended Language:

(PO, p. 154, and 169-171)

2. Staff

a) Merits of Proposed Energy Efficiency Program

In Staff's view, the Companies are asking ratepayers to fund a program that is not equitable. In other words, it is funded by all ratepayers, but the direct benefits only accrue to a limited subset of ratepayers. Some ratepayers will see few or no benefits and these may be homeowners that have just upgraded their houses or bought new residences. Others may be renters whose apartment manager does not take advantage of the program. And still others will view the return on their conservation investment as too low even with the benefits provided by an EEP. According to Staff, It is impossible to compare the cost that one individual has to pay with the benefits that others receive, or to determine that one individual's gain is worth more than another individual's loss. *Id.* at 32-36.

The EEP is also inefficient, Staff argues, because the conditions that are most likely to lead to demand for EEP services are those that already provide the best incentive to invest in conservation without an EEP. As gas prices rise, the return to saving gas usage increases, and there are more incentives for individual businesses and consumers to invest in conservation technology without any utility program. No base case for conservation spending absent the EEP has been established, Staff notes, and thus there is no way to measure the incremental effect of the EEP. While the benefits are likely to outweigh the cost for ratepayers receiving program benefits, it is less clear that this is true for ratepayers as a whole. For the entire program to have net benefits, Staff asserts, the value of the gain in technical efficiency from the program must be higher than the cost. (*Id.* at 33-36). And, even if the EEP has net benefits as a whole, Staff does not believe an efficient outcome is guaranteed. Some customers may be induced to invest in projects that are not cost effective by themselves, but the whole program may still have net benefits on average. In Staff's view, efficiency requires that the last individual project undertaken have net benefits.

Staff does not support using utility rates to fund conservation programs. It is concerned that such programs may reduce economic efficiency. According to Staff, ratepayers who may be investing at efficient levels absent the program might be induced to start investing in too much conservation by investing in projects that have negative net returns. This reduces economic efficiency. In contrast, a program financed through an income or property tax would have a smaller decrease in efficiency.

Staff notes that various parties to the docket make claims of aggregate or system-wide benefits. Staff points out that the claims are not well-founded. The parties have offered only vague assertions to bolster their claims for large system-wide benefits. Staff strongly disputes the

parties claim that it has been demonstrated that EEP can lower gas prices in Chicago.

Staff also finds the EEP design to be flawed. Staff has several concerns with how the EEP is to be administered. Foremost, Staff considers that the lines of command are not clear, i.e., it is not clear who controls which functions and who makes what decisions. This is important to Staff, since it does not appear that the Administrators are accountable to anyone. Staff believes that the organizational chart for the program (North Shore Ex. IR-1.1 and Peoples Gas Ex. IR-1.1) demonstrates the validity of this concern. There is an arrow from the Control Administrator to the Board and an arrow from the Board to the Program Administrator, but the chart does not indicate to whom the Administrators report. There also does not appear to be any way for the Board to limit administrative costs. If administrative costs are too high, Staff asserts, the extra costs will seriously undercut the EEP's effectiveness. Staff Ex. 12.0 Revised at 36-37.

Staff recommends that the organization be one that is accountable and efficient. The Board should appoint a Director that has clear authority to act both with respect to employees and programs. Employees should be enabled to select and administer the programs under the authority of the Director. It is not clear to Staff that the Program Evaluators need to be a separate group of employees such that the Director should use the inputs of the employees to select programs that the employees can evaluate. One way to help make the process effective is to conduct periodic management audits and use annual reports about the programs' effectiveness. Staff urges that these changes should be made no matter the method of rate recovery, i.e. rider or base rates. (*Id.* at 37). An important control that the Commission should impose on the EEP is to have a binding constraint on the amount of administrative costs that are incurred, and by requiring the Companies to periodically report their EEP overheads. *Id.*

Finally, in the event that the Commission approves EEP, Staff agrees with the Companies' witness Rukis that EEP not be funded above \$7.5 million per year. In addition Staff recommends that the Commission order the Companies to be responsible for the prudent choice of programs and efficient implementation of those programs. The Companies must be ultimately responsible for any EEP expenditures authorized. *Id.* at 38.

* * *

Commission Analysis and Conclusion

On the Merits of EEP

As a condition to the merger approved in In re WPS Resources, Inc., Docket 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. While the Commission is highly pleased to consider and accept the EEP and it commends the concerted efforts and good work that brought it to the table if finds that it cannot accept the imposition of the EEP costs on ratepayers at this time. We agree with Staff that the parties to this docket have not demonstrated that benefits from the EEP exceed the costs. Indeed no explicit programs are even provided in this docket. Rather an organizational structure is proposed to choose yet unknown programs to implement. While one of the goals of the PUA is to establish "...adequate, efficient, reliable, environmentally safe and least-cost public utility services..." (220 ILCS 5/1-102) the Companies and supporting parties have failed to demonstrate that the EEP will result in least cost service. The Companies failed to provide a base case on which to measure the incremental benefits of the EEP absent such a determination of incremental benefits the Commission cannot determine if EEP will result in least cost service. That is without understanding what investment would be without the program, the Commission is unable to determine how much investment would increase as a result of the program as opposed to investment that would occur under the program but not be induced by it, which undermines any claims of programs benefits. Finally we agree with Staff that the claims that EEP will result in lower gas prices in Chicago should be rejected given that gas is priced in a national market and the size of the proposed EEP program relative to the national gas market is a infinitesimally percentage of the total market demand in the United States and the effect of a very successfully EEP could have on the market demand would be even smaller.

~~Energy efficiency programs are consistent with the policy goals contained in the Public Utilities Act. 220 ILCS 5/1-102. Moreover, in the recent Nicor rate case proceeding, the Commission recognized the importance and critical necessity of using energy efficiency plans as strategic tools to protect Illinois consumers and reduce their energy costs. Order at 193, Docket 04-0779 (September 20, 2005).~~

~~As described on record, the 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. Further, 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.~~

~~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 energy efficiency program as proposed. We find the structure to be fair and reasonable. 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. And, the Commission considers Staff witness Rearden's proposal to cap administrative costs at 5% to be both reasonable and appropriate in these premises. Thus, Staff's recommendation is approved.~~

Rider Treatment

Staff takes exception to the Proposed Order's conclusion concerning rider treatment of EEP costs. Staff believes rider treatment is illegal and unwarranted for the reasons presented in its Initial and Reply Briefs. (Staff Init Br. At 210-213; Staff Reply Br. At 81-85) Staff specifically notes that the PO in its discussion of Rider ICR at page 145 notes and relies upon the Appellate Court's ruling in A. Finkl v. ICC, 250 Ill.App.3d 317, 326, (1993), in contradiction to its discussion on Rider EEP. The PO implies that in a rate case proceeding the burden imposed by an unexpected, volatile or fluctuating expense cannot be singled out. The PO then singles out the expense of an energy efficiency program in a rate case proceeding because the costs may be volatile and fluctuating for a limited period. (PO at 170) The court in Finkl specifically decided that a demand response rider was inappropriate as it violates the rule against single-issue rate making, and further concluded that this is a bar to rider recovery of costs that may be considered volatile, fluctuating, or unexpected. (250 Ill.App.3d at 326)

Moreover, Staff takes exception with the conclusion that these costs are volatile and fluctuating when in reality they may be underspent because the proper effort will not be exerted to use all available resources. This is also easily contradicted by the current Ameren and ComEd Energy Efficiency and Demand Response Dockets where the

utilities are mandated by the legislature to meet certain energy efficiency requirements six months after a three month process. (see ICC Docket Nos. 07-0539 and 07-0540)

Nevertheless, if the Commission does decide to adopt Rider EEP based on the merits of such a program, Staff recommends that the Commission express the expectation that the proposed recovery rider will only be in effect for a limited period of time, i.e., while the program is developing and the Governance Board may not be annually spending the full \$7.5 million.. The Proposed Order states that the manner in which the associated costs are spent will be out of the Company's control. (PO at 170) If this is the basis for employing the Commission's discretion to adopt a rider mechanism, then the rider should only be in effect while that premise is true. The PO assumes that spending could be volatile and difficult to forecast accurately in the early phase when the program is ramping up. (PO at 170) The PO further states that because the Companies do not have control of how much of the \$7.5 million will be spent each year, it should not be included in rate base. (Id.) However, as the program evolves, the costs should become more stable and predictable as is evidenced by the Companies' proposal to decrease and eventually eliminate the carry-over of portions of the budgeted \$7.5 million. At that juncture, the considerable resources necessary to implement the rider could not be justified and the best course would be to include the cost of conservation and energy efficiency programs in base rates.

In the event that Rider EEP is adopted, Staff therefore proposes that specific language be added to the Commission's conclusion that emphasizes it is approved on a temporary basis solely based on the unique findings in the Order, and will be revisited in the Companies' next rate case where Peoples Gas and North Shore will be required to

justify its continued implementation instead of simply adding the static \$7.5 million to base rates. The proposed language addition which would be inserted on p. 171 is as follows:

Although we do not adopt Staff's position, several of its proposals bear consideration. Staff witness Hathhorn recommends, if the Commission adopts the Rider EEP, that: 1) an annual reconciliation procedure should be established; 2) an internal audit should be conducted; and, 3) the monthly tariff filing date should be changed. The Utilities have agreed to these changes and we adopt them as well. The annual reconciliation will ensure that ratepayers are only charged for the actual costs of the energy efficiency program. Furthermore, we acknowledge Staff's concerns about the significant investment in resources necessary to administer the proposed Rider EEP. As the program matures, we expect the costs of conservation and energy efficiency programs will become more stable and predictable, thus eliminating the need for rider recovery of costs. Once that occurs, a rider mechanism will no longer be necessary for these costs, and rate base recovery will be appropriate. Thus, when the Companies file their next rate case, if they desire to continue Rider EEP, they should fully demonstrate its value to ratepayers and the regulatory process.

Furthermore, Staff takes exception that the PO does not conclude that the annual reconciliation for Rider EEP shall require that all costs to be recovered were "prudently incurred." Despite the fact that an independent Governance Board will determine the costs of the Companies' energy efficiency program, there must still be accountability of how ratepayer monies are spent. First of all, the independence of the Governance Board has not proven itself out. Secondly, independence does not in and of itself demonstrate prudence. Therefore, Staff proposes the following changes to the last paragraph of the Commission Analysis and Conclusion on page 171:

Although we do not adopt Staff's position, several of its proposals bear consideration. Staff witness Hathhorn recommends, if the Commission adopts the Rider EEP, that: 1) an annual reconciliation

procedure should be established; 2) an internal audit should be conducted; and, 3) the monthly tariff filing date should be changed. The Utilities have agreed to these changes and we adopt them as well. The annual reconciliation will ensure that ratepayers are only charged for the actual costs of the energy efficiency program prudently incurred.

VIII. COST OF SERVICE

IX. RATE DESIGN

C. Service Classification Rate Design

1. Uncontested Issues

e. Peoples Gas Service Classification No. 6

Staff does not agree with the Proposed Order's conclusion that Staff's proposal for Peoples Gas Service Classification ("SC") No. 6 was incomplete and unclear. Since the Proposed Order does not represent a significant difference from Staff's proposal for SC 6, however, Staff will not object to rates developed based upon the Proposed Order's conclusions on cost of service. Staff recommends the following changes to the PO.

Recommended Language

(PO, p. 219)

Commission Conclusion

~~Staff's account, first referenced on Reply Brief, is incomplete and unclear.~~ Based on what is before us, 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

Staff does not agree with the PO's conclusion that Staff's proposal for Peoples Gas Service Classification ("SC") No. 8 is incomplete. Since the Proposed Order does not represent a significant difference from Staff's proposal for SC 8, however, Staff will not object to rates developed based upon the Proposed Order's conclusions on cost of service. Staff recommends the following changes to the PO.

Recommended Language

(PO, p. 219)

Staff's position which appears ~~only~~ in its Reply Brief, has not been responded to ~~and is incomplete for our purposes~~. As such, we are compelled to find that 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

Staff does not agree with the Proposed Order's conclusion that Staff's proposal to establish bifurcation between SC 1 customers according to usage is somewhat vague and insufficiently detailed to permit full consideration (PO, p. 238), or the Proposed Order's conclusion that allowing customers to choose among a low-use or a higher-use rate would cause unnecessary problems and customer confusion (Id.). Under the Companies' proposal, a non-heating customer using a fairly high number of therms, though in the minority of non-heating customers, would pay more per therm of gas usage than a comparable heating customer using the same number of therms. For example, under current rates, a non-heating residential customer pays the same

amount for 70 therms of gas delivered as a residential heating customer (North Shore Ex. VG-1.6, page 3 of 4, column (f), line no. 29 (\$91.53) compared to page 4 of 4, column (f), line no. 22 (\$91.53); and Peoples Gas Ex. VG-1.7, , page 3 of 4, column (f), line no. 29 (\$100.78) compared to page 4 of 4, column (f), line no. 22 (\$100.78)). Under the Company's proposals, however, a North Shore SC 1N customer would pay \$103.17 for 70 therms of gas delivered (North Shore Ex. VG-1.6, , page 3 of 4, column (L), line no. 29) but a SC 1H customer would pay \$99.22 (North Shore Ex. VG-1.6, page 4 of 4, column (L), line no. 22). Also under the Company's proposal, a Peoples Gas SC 1N customer would pay \$118.38 for 70 therms of gas (Peoples Gas Ex. VG-1.7, page 3 of 4, column (L), line no. 29) but a SC 1H customer would pay \$110.04 (Peoples Gas Ex. VG-1.7, page 4 of 4, column (L), line no. 22). Staff believes that these are unreasonable results, but the PO apparently disagrees. In addition to concluding that it is too cumbersome for the utilities and confusing for customers to permit residential non-heating customers to choose for themselves whether to be billed a higher customer charge with a lower usage charge, the PO also disagrees with Staff's alternative recommendation to abandon the SC 1N and SC 1H bifurcation and combine the SC 1N and SC 1H cost information to determine a single SC 1 rate, which is how all SC 1 customers are currently billed. To avoid the unreasonable results of bifurcating SC 1N and SC 1H under the Utilities' proposals, the Commission should reject the bifurcation of SC 1 and the Proposed Order should be restated as follows:

Recommended Language

(PO, pp. 238-239)

Commission Analysis and Conclusion

The issue is whether to implement a bifurcation between S.C. No. 1N and 1H as the Utilities have here proposed. Having reviewed the evidence, the Commission considers the Utilities' proposal ~~to be both reasonable and based upon a method that is appropriate and supported by the record~~ inadequate at this time. We recognize that Staff witness Luth has included proposals for implementing an election procedure and he would 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. These are each interesting proposals in their own way. ~~In the end, however, the Commission believes that Mr. Luth's proposal to establish bifurcation along volumetric lines is somewhat vague and insufficiently detailed to permit full consideration. And, his customer election proposal brings up unnecessary problems.~~ The Commission agrees with the Utilities that the introduction of annual elections for service classifications would result in unwarranted complexity and it would bring about customer confusion. Further, the Commission is unable to ascertain precisely what benefits would be obtained by customers switching service classifications without a reasonable and appropriate reason for doing so. ~~And~~ However, the Commission believes that the Utilities bifurcation proposal along heating vs. non-heating lines ~~is a far more solid basis for the bifurcation since the Utilities have established that they maintain data and procedures which permit them to appropriately classify customer accounts accurately. This tells us too, that the distinction along these lines is settled.~~ can present problems for non-heating customers who use a fairly significant amount of gas. A non-heating customer using 100 therms of gas, though in the minority of non-heating customers, would pay more under the Utilities' proposals than a heating customer using the same 100 therms of gas. The Commission does not believe that this is a reasonable result. The bifurcation of SC 1 residential customers according to whether a customer is a heating customer or a non-heating customer is rejected. Cost of service information for SC 1N and SC 1H should be combined to maintain the current billing of residential customers which does not differentiate residential customers according to whether gas is used for heating purposes. Depending upon the results of the cost of service study after adjustment for the revenue requirement authorized in this Order, the customer charge at North Shore should be \$15.79 or less per month, and the customer charge at Peoples Gas should be \$14.69 or less per month. Unrecovered customer costs, if any, should be recovered through the first usage block.

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 believes is appropriate. In considering Mr. Glahn's approach, we find it inconsistent and outside the goals of increasing fixed cost recovery. As we see it, Mr. Glahn's proposal would

generate rates using the filed revenue requirement that are substantially below those proposed by the Utilities. It is difficult to evaluate in full 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, we do not believe the parties opposing the Utilities' proposal have demonstrated that the Utilities have employed anything less than the settled broad objectives of rate design, including social goals, in the S.C. No. 1N and S.C. No. 1H proposals at hand. In the final analysis and with these same considerations in mind, the Commission believes that the Utilities' proposals represent the most reasoned approach to establishing just and reasonable rates for small residential heating and non-heating customers.~~

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

Please see Staff's exceptions to Peoples Gas Service Classification Nos. 1N and 1H, supra.

c. Peoples Gas Service Classification No. 2

Staff does not agree with the Proposed Order's conclusion that Staff's proposal for Service Classification No. 2 does not appear to be based upon any cost basis or other persuasive reason. However, Staff believes that rates developed through the cost of service study conclusions in the PO will result in SC 2 rates that are reasonably consistent with Staff's recommendations in this docket. Staff recommends the following changes to the PO.

Recommended Language

(PO, p. 242)

The Commission considers the Company's proposal to be the most reasonable means to design the S.C. No. 2 rates. Mr. Glahn's proposal lacks sufficient analysis. If not arbitrary, it is at times inconsistent. While gradualism is certainly a goal, it may be overshadowed by other equally important considerations. We seriously question why Mr. Glahn proposes to not increase the S.C. No. 2 customer charges in a general rate increase

framework. While Mr. Luth's proposal to change the S.C. No. 2 demand device and administrative charges would result in proper cost recovery, we decline to adopt his proposal at this time because the demand device and administrative charges apply to other service classifications as well as S.C. No. 2. ~~is not defended on Reply Brief and does not appear to be based on any cost basis or other persuasive reasoning.~~ On the whole, the increases proposed by the Utilities are shown to be ~~warranted~~ necessary.

d. North Shore Service Classification No. 2

Please see Staff's exceptions to Peoples Gas Service Classification No. 2, supra.

e. North Shore Service Classification No. 3

Staff believes that rates developed through the cost of service study conclusions in the PO will result in SC 3 rates that are reasonably consistent with Staff's recommendations in this docket. Staff also believes that SC 3 rates developed in Staff's rebuttal testimony were reasonable and were not sufficiently different from rates that would result from the PO's conclusions on cost of service to warrant objection at this stage of the docket.

Recommended Language

(PO, p. 243)

The Commission accepts the Company's S.C. No. 3 proposal. Staff noted, in its brief on exceptions, that the rates it developed for SC 3 were not sufficiently different from rates that would result from the Company's rates to warrant an objection. ~~It is unclear to us whether there is an objection to it or a counter proposal. But, we note that Staff does not address this issue in either of its briefs.~~

f. Peoples Gas Service Classification No. 4

The combination of current SC 3 customers with current SC 4 customers could potentially cause rate shock to current SC 3 customers with lower load factors than current SC 4 customers. Staff believes that Staff's rebuttal SC 4 rates were reasonable

and attempted to address potential rate shock resulting from a change in billing emphasis from usage-based revenues to demand-based revenues from current SC 3 customers. At this stage of the docket, Staff will not object to the PO's conclusions on the combination of Peoples Gas SC 3 customers with SC 4 customers at Peoples Gas.

Recommended Language

(PO, p. 245)

The Commission accepts the Company's proposal to combine the two service classifications, noting that we have not been presented with any persuasive evidence why the two service classifications should remain separate in view of the convergence of load factors that has been demonstrated. Staff in its exceptions indicated that at this stage of the proceeding it was no longer contesting this issue. ~~Staff does not address this issue in its briefs.~~ Further, City-CUB have not set out an effective or meaningful analysis for their proposals.

g. Peoples Gas Service Classification No. 7

D. Tariffs – Other Tariff Issues

3. Rider 4, Extension of Mains

The PO states the following at page 250, second full paragraph:

Staff witness Harden found the proposed language to be very broad and that it refers to charging customers, with no limit, for labor costs, material costs, transportation costs, overheads and return. Staff requested additional support and/or explanation for proposed language changes to Rider 4. Staff Exhibit 9.0 at 26-27. Staff was not satisfied by the additional information in

The next paragraph then goes on to state:

Through the Companies' rebuttal testimony (North Shore/Peoples Gas Ex. VG-2.0 at 53) Staff continued to object to the proposed language of a "return" being charged to customers through Rider 4. Staff Exhibit 21.0 at 5. In surrebuttal testimony, however, the Companies agreed to remove the "return" language from the Rider. North Shore/Peoples Gas Ex. VG-3.0 at 29. With the removal of "return" from the proposed language Staff states that its prior concerns are now satisfactorily addressed.

(PO, p. 250) It is Staff's supposition that the PO intended for the two paragraphs to be one with the last sentence in the first full paragraph being completed with the first sentence in the second full paragraph. Staff believes therefore that the PO was intended to read as follows:

Recommended Language

Staff witness Harden found the proposed language to be very broad and that it refers to charging customers, with no limit, for labor costs, material costs, transportation costs, overheads and return. Staff requested additional support and/or explanation for proposed language changes to Rider 4. Staff Exhibit 9.0 at 26-27. Staff was not satisfied by the additional information in ~~Through~~ the Companies' rebuttal testimony (North Shore/Peoples Gas Ex. VG-2.0 at 53) Staff continued to object to the proposed language of a "return" being charged to customers through Rider 4. Staff Exhibit 21.0 at 5. In surrebuttal testimony, however, the Companies agreed to remove the "return" language from the Rider. North Shore/Peoples Gas Ex. VG-3.0 at 29. With the removal of "return" from the proposed language Staff states that its prior concerns are now satisfactorily addressed.

X. TRANSPORTATION ISSUES

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

2. Customer Enrollment

a. Customer Data Issues

Staff has consistently opposed providing any customer-specific information when the customer's consent is not acquired. The Utilities gather that information in their role as a public utility. The Utilities should not be required to provide it to non-utility entities without the customer consciously agreeing. (Staff IB, p. 261) Supplying customer names and addresses without positive customer consent also contradicts the Commission's ruling in Docket No. 04-0779. (ICC Docket No. 04-0779, Order Dated September 20, 2005, p. 171)

The arrangement in the PO differs from what is done at Nicor. As previously mentioned, Nicor does not provide customer lists absent customer consent. Furthermore, while it is not in the record in this case and does not appear in the order in the Nicor case, it is Staff's belief that although Nicor makes information about usage by customers available for a fee, the private information of individual customers is only provided upon receiving customer consent. In addition, not including customers' phone numbers in the information does not fully prevent telemarketing. For many customers, only a phone book is needed to recover phone numbers once one has the customer's name and address.

Recommended Language

(PO, p. 283)

Commission Conclusion

As a general proposition, the Commission will require the Utilities to supply the information described in the four categories above, except for the residential customer list, thereby providing the mandate the Utilities apparently seek. That said, RGS and NAE raise several specific issues concerning the manner in which the pertinent data would be furnished. Consequently, the general approval announced in this paragraph is modified by, and subject to, the specific conclusions articulated in the subsections below.

We decline to order the Utilities to provide customer lists due to privacy concerns. Staff notes that the information is customers' data. In Nicor's last rate case (Docket No. 04-0779), the Commission declined to order Nicor to provide customer information lists. (Docket No. 04-0779, Order Dated September 20, 2005, p. 171) Consistent with that order, the Commission will not sanction the provision of this information to marketers. ~~A~~We note also, that the Utilities and NAE appear to disagree about the inclusion of phone numbers among the data that must be disclosed. ~~¶~~As the Commission is not inclined to abet providing customer information to telemarketersing, whether phone numbers should be and will not require disclosed or not ofis moot phone numbers. ~~Alternative providers can attract inbound calls and email communication through mailings.~~

Similarly, ~~Further~~, NAE disagrees with Staff (Staff Init. Br. at 261) and the Utilities (PGL-NS Init. Br. at 214) about prohibiting CFY suppliers from using the customer's information for any "non-utility service" or "for any purpose other than in connection with gas service." The Commission believes that such a prohibition is appropriate, however. Our function is to oversee public utility services, not to promote non-utility marketing schemes or customer data sales (especially when we have required transmission of certain customer data without charge). Consequently, Utility contracts for information transfers should bar re-transfer of the data furnished for purposes other than provision of gas service. However, we do not, and cannot, preclude alternative providers from obtaining information directly from customers or other sources, subject to whatever limits may be attached.

XI. UNION PROPOSALS

XII. FINDINGS AND ORDERING PARAGRAPHS

Staff requests that finding (20) of the Commission's Order allow seven working days, rather than only three calendar days stated in the PO, for review of the tariffs that North Shore and Peoples Gas will file in compliance with this Order. Three calendar days is simply an insufficient period of time for Staff and the Companies to work out any issues regarding how rates will allow the recovery of revenues authorized in the Commission's Order. For example, if the Companies presented revised rates on a Friday, the Proposed Order would allow those rates to go into effect on the following Monday, with little or no opportunity for Staff to review those rates. Even if the Companies filed revised rates on a Monday to go into effect on the following Thursday, Staff will not have seen those rates, and many of the assumptions in determining those rates, prior to the filing. The Commission's Order will likely be of the same approximate length as the 301-page PO. Three calendar days is not sufficient to determine whether rates properly recover the revenue requirement authorized in the Commission's Order

and whether the changes in rates are in agreement with the conclusions in the Commission's Order.

Finding (20) further requires the correction of tariff sheets within the three day period between filing and effective date of the tariff sheets. It is possible differences of opinion could not be resolved in the additional time allowed in seven working days, but the additional time would allow exchanges of information that are better thought-out than more hastily exchanged information that could result with only three calendar days of review. The recent Order on Rehearing in Northern Illinois Gas Company Docket No. 04-0779, a rates docket involving a natural gas distribution company comparable to North Shore and Peoples Gas, allowed seven days for review of tariffs that had already been extensively reviewed subsequent to the Commission's Order issued six months before the 14-page Order on Rehearing had been issued. (Order on Rehearing, Docket No. 04-0779, dated March 26th, 2006, p. 13) In the dockets currently under review, the 301-page PO covers the revenue requirement and rates of two companies, rather than only one company. Unlike the rates reviewed after the Order on Rehearing in Docket No. 04-0779, the North Shore and Peoples Gas rates to be filed based upon the revenue requirement authorized in the Commission's Order and the Commission's conclusions on cost of service and rate design have not been previously presented. A review period of seven working days, rather than only three calendar days provided in the PO, is reasonable and appropriate for review of North Shore and Peoples Gas rates to be filed in compliance with the Commission's Order at this stage of these dockets.

Staff respectfully requests a revision in the Proposed Order to state the following:

Recommended Language

(PO, p. 300)

(20) new tariff sheets authorized to be filed by this Order should reflect an effective date not less than ~~three(3)~~ seven (7) working days after the date of filing, with the tariff sheets to be corrected, if necessary, within that time period.

CONCLUSION

WHEREFORE, for all the reasons set forth herein, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding.

Respectfully submitted,

JOHN C. FEELEY
CARMEN L. FOSCO
ARSHIA JAVAHERIAN
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jfeeley@icc.illinois.gov
cfosco@icc.illinois.gov
ajavaher@icc.illinois.gov

*Counsel for the Staff of the
Illinois Commerce Commission*

December 14, 2007