

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

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

**REPLY BRIEF ON EXCEPTIONS OF  
NORTH SHORE GAS COMPANY AND THE  
PEOPLES GAS LIGHT AND COKE COMPANY**

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**REPLY BRIEF ON EXCEPTIONS OF  
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In accordance with the schedule set forth in the Administrative Law Judges’ (the “ALJs”) Proposed Order of November 26, 2007 (the “Proposed Order”), and Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (the “Commission” or “ICC”), 83 Ill. Adm. Code § 200.830, North Shore Gas Company (“North Shore”) and The Peoples Gas Light and Coke Company (“Peoples Gas”) (together, “the Utilities” or “Companies”) submit this Reply Brief on Exceptions.

**INTRODUCTION AND SUMMARY**

The basic legal duty of the Commission in contested rate proceedings is to establish rates that are just and reasonable for customers, the utility, and its shareholders based on the evidence in the record and the applicable law. *E.g.*, 220 ILCS 5/9-201(c), 10-103, 10-201.

The Proposed Order fulfills the Commission’s duty in most respects. In their Brief on Exceptions, North Shore and Peoples Gas identified four major respects in which the Proposed Order should be modified based on the evidence and the law. North Shore and Peoples Gas started these rate cases, their first since 1995, and their first since Integrys Energy Group, Inc.,

became their ultimate parent company, by filing fair and sensible revised tariffs and new Riders that: (1) reflect their actual costs of providing safe, adequate, and reliable service, including their costs of capital; (2) reflect cost-causation, while employing gradualism in moving more fixed costs out of volumetric charges and into customer charges; (3) in the case of Peoples Gas, provide a practical means for accelerating the replacement of cast iron and ductile iron main in the City of Chicago; (4) reflect public policy and best practices for natural gas utility ratemaking in 2007, not 1995, by mitigating the effects of unusually cold and unusually warm weather on gas bills and revenues, and by encouraging energy efficiency; and (5) improve their transportation programs. During the course of these proceedings, the Utilities listened to Staff and intervenors and accepted many changes, including no fewer than 20 rate base and operating expenses adjustments. North Shore and Peoples Gas also have paid heed to the Proposed Order. They did not file every possible Exception that they could based on the evidence and the law. They filed the Exceptions that they believe are required to have new Schedules of Rates that allow achievement of the above five objectives, are just and reasonable, and are approved by a final Order that is sustainable on appeal.

In their Post-Hearing Reply Brief, North Shore and Peoples Gas observed that many of the positions taken by “GCI”<sup>1</sup> and Staff not only lacked merit, but also suffered from two serious overall problems -- inconsistency and rigidity -- and the Utilities provided a number of detailed examples. NS-PGL Reply Brief (“Reply Br.”) at 1-8.

Unfortunately, GCI’s and Staff’s Exceptions suffer from the same two problems. Apart from GCI’s apparently recognizing the practical significance of climate change and backing off

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<sup>1</sup> The Illinois Attorney General’s Office (the “AG”), the Citizens Utility Board (“CUB”), and the City of Chicago (the “City”) (collectively “GCI”).

of its opposition to use of a more accurate weather normalization period in order to determine billing determinants, GCI's and Staff's Exceptions reflect the same inconsistencies and rigidity in their applicable positions that the Utilities documented two briefs ago (almost two months ago).

Moreover, Staff and GCI have become even more strikingly inconsistent about the significance of prior Commission Orders. On some issues, they continue to treat prior Commission Orders essentially as dispositive, such as when they reject certain upward adjustments to a utility's costs of common equity ("ROE"). On other issues, such as GCI's huge proposed adjustments to the Utilities' depreciation reserves, prior Commission Orders that expressly reject the same adjustments based on similar facts apparently are confused and of little or no consequence, from GCI's and Staff's perspectives.

Staff's and GCI's positions at this stage of these proceedings also continue to suffer from inflexibility. Staff, whose proposed ROEs were approved by the Proposed Order, is standing pat on the results of its approach to determining ROEs, even though the evidence and briefing has shown that Staff's methodology yields results that are unrealistic and cannot be squared with other recent Commission Orders, including giving the Utilities lower ROEs than the Commission has set for any gas utility in over 30 years. GCI has filed Exceptions that reiterate several of its already debunked theories that would yield far lower ROEs, although GCI in its Exceptions has shied away from presenting the results of those theories in terms of specific ROE figures.

Staff's rigidity is especially pronounced on the subject of its proposed Hub adjustments. Staff is litigating those adjustments (which the Proposed Order at 111-113 correctly rejects), with a startling vehemence -- startling in that Staff is trying to exact disallowances from Peoples Gas that are not really based on the facts of this case but rather on Staff's continued deep

dissatisfaction with the Gas Charge settlement; startling because Staff's position has been shown to be incorrect in so many ways in these cases, including at times through Staff's own testimony on cross-examination; and startling because Staff's attack on the Hub disregards that all Hub revenues are credited to customers per Commission Order, with over \$20 million credited in 2005 and 2006 and another \$13 million in revenues expected in 2007. Staff quotes entire passages from the Gas Charge opinion criticizing Peoples Gas' management. Since that order, the Commission approved the reorganization in *In re WPS Resources Corp., et al.*, ICC Docket No. 06-0540 (Order Feb. 7, 2007), that made Integrys the parent of Peoples Energy Corporation, which in turn is the parent of the Utilities. Lawrence Borgard is now the President and Chief Operating Officer of Integrys Gas Group and Vice Chairman of the Board and Chief Executive Officer of North Shore and Peoples Gas. The Companies, it is undisputed, are fully carrying out the Commission's Conditions for approving the reorganization. The Gas Charge settlement approved by the Commission is being fully implemented. There is no basis for Staff's living in the past with regard to the Hub.

North Shore's and Peoples Gas' Exceptions should be approved by the Commission. The Commission should not approve the Exceptions of Staff and intervenors that the Utilities oppose, for the factual and legal reasons discussed below.

#### **ARGUMENT IN REPLY TO STAFF'S AND INTERVENORS' EXCEPTIONS**

Please note that the Utilities have included only those sections of the consensus common outline adopted by the Administrative Law Judges in these proceedings as to which Staff and intervenors are proposing Exceptions to the Proposed Order.

## II. RATE BASE

### D. Reserve for Accumulated Depreciation and Amortization

#### 1. GCI's Proposed Adjustments

The Proposed Order correctly rejects GCI's proposed adjustments to the Utilities' depreciation reserves, which in effect would change the test year for the reserves to 2007 by adding a full year of depreciation expense. The Proposed Order's ruling is in accordance with the law and ratemaking principles and is based upon the facts shown by the evidence in the record. Proposed Order at 17-18. The Proposed Order indicates that the ALJs: "Having reviewed the evidence and the arguments of the parties, found that the facts at hand most closely resemble the situation that we most recently considered in Docket 05-0597 (that concerns Commonwealth Edison Company)." Proposed Order at 18 (emphasis added). In *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597 (Order July 26, 2006), the Commission rejected the proposal by GCI witness Mr. Effron relating to the utility's depreciation reserve, which the Proposed Order here concludes is "essentially the same" as the proposal of Mr. Effron in this proceeding. Proposed Order at 18. Furthermore: "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." Proposed Order at 18 (citing Order in ICC Docket No. 05-0597 at 15). Obviously, because the facts in this case most closely resemble the facts in the ComEd case, the cases relied upon by GCI in this proceeding are also inapplicable and without merit.<sup>2</sup>

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<sup>2</sup> There was a rehearing in ICC Docket No. 05-0597 on certain issues, but the Commission expressly denied the AG's request for rehearing on GCI's proposed adjustments to the utility's depreciation reserve. *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, at 2-3, 4 (Order on Rehearing Dec. 20, 2006).

In their Brief on Exceptions, City-CUB disingenuously attempt to attack the Proposed Order's solid factual findings and conclusions by making a straw man argument that the ALJs merely reasoned that the Utilities made arguments in this proceeding that were similar to those made in the ComEd case, with City-CUB then concluding that "[n]o accepted principle of legal analysis and no provision of the [PUA] permits such reliance of the mere presence of arguments, to the exclusion of facts shown by the evidence". City-CUB Brief on Exceptions ("BOE") at 7. That is a baseless attack on the ALJs. As quoted above, the Proposed Order expressly is based on the evidence and the facts shown by that evidence. Proposed Order at 18.

The facts included in the evidentiary record demonstrate that, just as in the ComEd case, the Utilities have experienced significant growth in net plant. PGL Exhibit ("Ex.") SF-1.1, Schedules ("Scheds.") B-5 and B-6; NS Ex. SF-1.1, Scheds. B-5 and B-6. Also *compare* PGL Ex. SF-1.1, Sched. B-1, line 3, column [D], *with* the level of net plant approved in Peoples Gas' 1995 rate case (*In re The Peoples Gas Light and Coke Company*, ICC Docket No. 95-0032 (Order Nov. 8, 1995), Appendix ("App.") A, Sched. 1, line 4, column [D]).

Moreover, the evidentiary record as well as the briefing shows that the Companies have proposed *pro forma* adjustments for capital additions in the final revised gross amounts of \$95,697,000 and \$8,908,000, respectively, that are not contested by any party, and that the correct amounts of the adjustments to the depreciation reserves for those capital additions also are undisputed. *See, e.g.*, the citations in NS-PGL Initial Brief ("Init. Br.") at 16-17.

Those uncontested facts distinguish the instant cases from the prior Commission decisions on which City-CUB relies, and make them most closely resemble the ComEd cases. No amount of argument can change that, although City-CUB goes on for page after page trying to do so.

Despite their attack on the ALJs' reasoning, City-CUB do not attempt to distinguish the facts of the ComEd case from the facts of the instant proceeding, except by presenting their incomplete and inaccurate discussion of the facts here. Instead, they trot out citations to *In re Central Illinois Light Co.*, ICC Docket No. 02-0837 (Order Oct. 17, 2003), including a lengthy quote from the Commission's Order therein (City-CUB BOE at 15), despite the fact that the ALJs in the instant proceedings correctly found that that case was inapplicable and without merit as applied to the facts of the instant proceeding, as cited above. City-CUB's Brief on Exceptions offers nothing of merit to support the adjustment of GCI witness Mr. Effron rejected by the Proposed Order.

GCI in none of its briefs<sup>3</sup> has presented a complete and accurate discussion of the relevant facts and holdings of all of the recent Commission decisions cited by the parties on this subject. For such a discussion, see pages 13-18 of North Shore's and Peoples Gas' Reply Brief, which show that given the proven facts of the instant case, the same result as the ComEd cases (ICC Docket No. 05-0597 and *In re Commonwealth Edison Co.*, ICC Docket No. 01-0423, pp. 44-45 (Order March 28, 2003)) is the only correct and consistent result. GCI attempts to cloud the issue by asserting that the "Commission has taken varying positions on this issue" (City-CUB BOE at 11), but the prior decisions are consistent when the facts of each Docket are taken into account, something GCI has never done.

GCI witness Mr. Effron's proposed adjustments to the Utilities' depreciation reserves, which in effect change the test year for the reserves to 2007 by seeking to add a full year of depreciation expenses to the reserves, are inconsistent with test year principles and with the

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<sup>3</sup> GCI has submitted separate briefs as City-CUB and the AG, while jointly sponsoring the GCI witness, Mr. Effron, here.

Commission's *pro forma* adjustments rule, 83 Ill. Adm. Code § 287.40. NS-PGL Init. Br. at 18-21; Staff Ex. 15.0 Corr., at 17. City-CUB's arguments to the contrary (City-CUB BOE at 10, *et seq.*) are sophistry. City-CUB's revenue requirement mismatch argument is wrong and, indeed, has it backwards. No party does or can dispute that the correct net amounts for the Utilities' *pro forma* adjustments for capital additions have been determined and are undisputed, as noted above. Instead, GCI is trying to use those *pro forma* adjustments as a pretext or excuse for moving forward by one year the depreciation reserves for the Utilities' existing plant, not the plant involved in the *pro forma* adjustments. There is no dispute that GCI's proposal is based on the depreciation associated with existing plant, not the *pro forma* capital additions. GCI's arguments about whether its proposal meets the *pro forma* adjustments rule standards does not alter that GCI is trying to change the test year for the depreciation reserves, while not changing it for other rate base elements or operating expenses.

City-CUB's new argument, that calculating the *pro forma* adjustments for capital additions to incorporate the depreciation associated with those additions but not to move forward the depreciation reserves for existing plant violates the single issue ratemaking prohibition (City-CUB BOE at 17-18) is wrong and absurd. The authorities cited by GCI relate to the rate base or revenue requirement impacts of an item, which in the case of the *pro forma* adjustments for capital additions have been fully calculated and applied. They do not require or support making unrelated adjustments to the depreciation reserves related not to the capital additions but to existing plant. City-CUB cites no court decision rejecting the way *pro forma* adjustments for capital additions are calculated in Commission practice. If City-CUB were right, then, at a guess, dozens, probably hundreds, of Commission Orders would have violated the single issue

ratemaking prohibition by approving *pro forma* adjustments for capital additions calculated exactly the same way they were in the instant proceeding.

City-CUB also argue that since Peoples Gas' last rate case through 2006, its net plant increased by only slightly more than the net plant amount of Peoples Gas' pro forma capital additions. City-CUB BOE at 19. That argument lacks merit. First, it does not alter that the *pro forma* adjustments for capital additions in all respects have been correctly calculated and applied. Second, City-CUB is playing it loose as to the definition of net plant, by adding in deferred taxes. Net plant is gross plant minus Depreciation Reserves, as innumerable Commission Orders in their text and Appendices have treated it. Peoples Gas' net plant increased by \$212,824,000 during that period, not, as City-CUB would have it, by "approximately \$95 million". Compare PGL Ex. SF-1.1, Sched. B-1, line 3, column [D], with the level of net plant approved in Peoples Gas' 1995 rate case (Order in ICC Docket No. 95-0032, App. A, Sched. 1, line 4, column [D]). Third, in the period from fiscal year 2003 to fiscal year 2006, the period required to be covered by the Commission's rules regarding Schedule B-5, Peoples Gas' gross additions have been \$68,001,000, \$73,561,000, \$68,702,000, and \$86,892,000, respectively (PGL Ex. SF-1.1, Sched. B-5, line 14), which is not out of line with the undisputed gross amount for the utility's *pro forma* adjustment for capital additions. See also PGL Ex. SF-1.1, Sched. B-6 (depreciation reserve changes during this period); NS Ex. SF-1.1, Scheds. B-5 and B-6 (gross plant and depreciation reserve changes during this period). Finally, GCI conveniently ignores the role of *pro forma* adjustments for capital additions in mitigating regulatory lag in historical test year rate cases. Peoples Gas' revenue deficiency based on its adjusted 2006 test year is, per the Proposed Order, \$62,868,000. Proposed Order, App. A, page 1, line 27. Yet, the rates being set in this case for Peoples Gas

will not go into effect until 2008. The *pro forma* adjustment for capital additions is the primary mechanism by which the Commission diminishes regulatory lag. GCI's position would largely nullify that by adding its unrelated Depreciation Reserves adjustment for another year of depreciation on existing plant. GCI's remaining discussion of the facts (City-CUB BOE at 18-21) is off point, incomplete, and inaccurate for the reasons discussed above.

In its Brief on Exceptions, the AG basically launches the same erroneous attack on the ALJs as did City-CUB, again basically asserting that the cases on which it relies, which were rejected by the ALJs after a reasoned analysis of the facts shown by the evidence and the arguments, are more on point than the ComEd case (ICC Docket No. 05-0597), the case which the ALJs correctly found to have involved facts that most closely resemble the facts in the instant proceeding. *See* AG BOE at 1-6. The AG, however, adds the point that it finds that the statement in the Proposed Order that the change in the position of the Commission Staff to be of no consequence to be "especially curious". AG BOE at 5. Obviously, the conclusion contained in the evidence offered by Staff witness Mr. Kahle in this proceeding (which testimony was never withdrawn), which opposed Mr. Efron's adjustment as inconsistent with the Commission's *pro forma* adjustments rule, 83 Ill. Adm. Code § 287.40 (Staff Ex. 15.0 Corr. at 17), was in line with the Proposed Order's conclusion that the facts in the instant proceeding were consistent with those in the ComEd proceeding and that GCI witness Mr. Efron's proposal was improper and should be rejected is consistent with the result reached in the Proposed Order. In contrast, Staff's decision, for whatever reason, to take a position beginning with its Reply Brief, after the evidence was received in this proceeding, contrary to the evidence sponsored by its own witness, was "without consequence", because it is contrary to the Commission's decision

in the case, the ComEd case, having facts most closely related to the facts in the instant proceeding.

The AG refers to the decision involving ComEd in ICC Docket No. 05-0597 as “one isolated Commission decision” (AG BOE at 2-3), but that is specious. The AG conveniently ignores the decision involving ComEd in ICC Docket No. 01-0423. Even more importantly, the decision in ICC Docket No. 05-0597 is the one that has facts that most closely resemble the facts of the instant proceeding, as the Proposed Order correctly finds. To refer to the most on point case of the many cited by the parties as “one isolated Commission decision” is playing with words.

The AG, like City-CUB, makes the same mischaracterization of the change in Peoples Gas net plant since its last rate case discussed above. *See* AG BOE at 3. City-CUB’s and the AG’s criticism of the Proposed Order for failing to address expressly that historical comparison lacks merit. The AG’s remaining arguments parallel City-CUB arguments shown to be without merit, as discussed above and in prior briefing. The Proposed Order has it right. GCI’s proposed adjustments to the Utilities’ depreciation reserves lack merit and should be rejected.

**E. Cash Working Capital**

As noted in the Utilities’ Brief on Exceptions (at 4-10), Peoples Gas and North Shore are not filing Exceptions to the discussion, analyses, and conclusions on the subject of cash working capital (“CWC”) in the text of the Proposed Order, but they have filed Exceptions on the grounds that they believe the CWC amounts have been incorrectly calculated, due to errors, in three respects. Staff has filed an Exception on the subject of CWC, but that Exception lacks merit, ignores the errors, and should not be adopted.

## 1. Exclusion of Capitalized Expenses

Staff's sole objection to the CWC discussion, analyses and conclusions included in the Proposed Order relates to the treatment of capitalized payroll-related expenditures. Staff BOE at 7-9. Staff continues to assert that such capitalized payroll-related expenditures should be included in the Companies' CWC analyses because they require cash outlays. *Id.* Staff's assertion ignores established accounting rules and is inherently inconsistent. Accordingly, the Commission should reject it.

As correctly noted in the Proposed Order, “[v]irtually everything a utility purchases involve [a] cash outlay, but the purchase is either capitalized or expensed, not both”. Proposed Order at 21. Thus, as more fully explained below, the fact that a utility pays out cash is not dispositive for purposes of CWC analysis.

With respect to capitalized expenditures, investors are authorized to earn a return. With respect to cash outlays that are expensed (*i.e.*, operating expenses), however, investors are authorized to earn a return only to the extent that they are required to advance monies needed to fund a utility's daily operations, which may become necessary due to the imbalance between a utility's collection of revenues and payment of expenses. *E.g.*, Proposed Order at 18-19. Thus, as the Proposed Order succinctly states, “relevant accounting rules and test year mechanics are clear – capitalized items enter rate base and operating expenses do not.” Proposed Order at 20. The purpose of CWC analysis is to determine the extent of investor-provided financing of operating expenses so that investors can earn the return permitted for financing operating expenses.

Staff neither challenges the foregoing principles nor disputes them in any way. Instead, Staff simply encourages the Commission to ignore them – at least with respect to capitalized

payroll-related expenditures. The Commission should reject Staff's invitation. It is not supported by any policy justification. It is not supported by any evidence in the record. Further, it is unjustifiably selective. Staff does not acknowledge or even attempt to explain why capitalized payroll-related expenditures should be included in the Companies' CWC calculations simply because they require cash outlays but all other capitalized expenditures that require cash outlays should continue to be excluded from such calculations.

For the reasons set forth above, the Companies properly excluded capitalized payroll-related expenditures from their CWC calculations and the Proposed Order correctly upholds their exclusion. However, as explained in the Companies' Brief on Exceptions and noted above, the CWC calculations in the Appendices to the Proposed Order include certain mathematical errors relative to capitalized payroll-related expenditures that are in need of correction (and these errors do affect numbers in the text of the Proposed Order). NS-PGL BOE at 4-9. For the reason's described above, Staff Exceptions relating to CWC should not be adopted.

## **2. Removal of Depreciation and Amortization**

Additionally, Staff ignores that the Proposed Order's CWC calculations need to be corrected to exclude depreciation and amortization expenses, which the Proposed Order expressly recognizes are non-cash items that are not available to pay expenses. Proposed Order at 19, fn. 3; NS-PGL BOE at 4-8. Depreciation and amortization expenses were excluded from CWC calculations, for example, in the recent Ameren cases. *In re Central Illinois Light Co., et al.*, ICC Docket No. 06-0070 Cons., Appendix A, page 8, line 11, Appendix B, page 8, line 11, and Appendix C, page 8, line 11 (Order Nov. 21, 2006).

### **3. Incorporation of Pass Through Taxes**

Also, Staff ignores that the treatment of pass through taxes in the CWC calculations in the Proposed Order needs correction. *See* NS-PGL BOE at 4-7, 9-10. Although the dollars the Companies paid out for pass through taxes were included as expenses, the dollars that Companies collected from their customers in connection with pass through taxes were inadvertently (or incorrectly) excluded from revenues. The Companies believe this has occurred because the Proposed Order overlooks the fact that there already is a ratemaking adjustment that excludes these taxes from revenues. That adjustment, made by the Utilities and supported by Staff and not refuted by any party, is necessary for computational purposes, i.e., to compute the base rate revenue increase. PGL Ex. SF-1.0, at 23; PGL Ex. SF-1.1, at 33; NS Ex. SF-1.0, at 22; NS Ex. SF-1.1, at 29.

### **4. Overall Conclusion on Cash Working Capital**

Corrections of the above-described errors, which Staff's Exception overlooks, will result in a level of Cash Working Capital that is reasonable based on the evidence in the case and which is supported by the discussion, analysis and conclusions included in the text of the Proposed Order. As indicated in the Proposed Order at 19, the Companies' calculations produce CWC allowances of \$30.9 million for Peoples Gas and (\$1.1 million) for North Shore, while Staff's proposed adjustments would decrease the amounts to \$16.6 million and (\$1.7 million), respectively. The miscalculation or mishandling of the foregoing items in the Proposed Order results in CWC amounts for Peoples Gas (negative \$12.1 million) and for North Shore (negative \$4.5 million), which is clearly incorrect and unreasonable based on the Staff and Company positions. A reasonable outcome would be an amount between the Staff and Company positions. Correction of the errors in the Appendices will produce that result (\$24.9 million and

(\$1.3 million), respectively). See the detailed Exceptions to the Proposed Order of [North Shore and Peoples Gas] (“NS-PGL Exceptions”), Exception Nos. 1-4, with replacement corrected Appendix A, Page 10 of 15, and Appendix B, Page 10 of 15.

**G. OPEB Liabilities and Pension Asset/Liability**

The Proposed Order adopts the OPEB liabilities adjustments advocated by Staff and GCI, subject to partial offsets consisting of the Utilities’ test year pension contributions. Proposed Order at 35-36. In their Brief on Exceptions, the Utilities contended that the evidence most strongly supports excluding Peoples Gas’ pension asset *and* OPEB liability, and similarly, excluding North Shore’s pension liability *and* OPEB liability and that, in the alternative, if the Commission approves the Proposed Order’s reduction of rate base by the amount of the Utilities’ OPEB liabilities, then the Order should, in turn, recognize not the Utilities’ pension contributions as such, but, instead, Peoples Gas’ pension asset of \$110,000,000 and North Shore’s pension liability of \$24,000. NS-PGL BOE at 14-16. The Utilities argued, in the alternative, that if neither of those two positions were to be adopted, then the position next most consistent with the evidence and reasonable is that taken by the Proposed Order, adopting the OPEB liabilities adjustments offset by the Utilities’ test year contributions. *Id.* at 16-17. In contrast, GCI’s and Staff’s Exceptions urge the least consistent of those three positions, adopting the OPEB liabilities adjustments but rejecting any offsets not only for Peoples Gas’ pension asset but even for the Utilities’ test year contributions. City-CUB BOE at 22-23; AG BOE at 6-7; Staff BOE at 9-11.<sup>4</sup> Their Exceptions should not be adopted.

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<sup>4</sup> Staff also correctly notes, as did the Utilities in their motion to correct mathematical errors in the Proposed Order, that the Proposed Order contains the mathematical error of double-counting North Shore’s test year pension contribution. Staff BOE at 12.

The uncontested facts in this case are most similar to the Commission's Order in *In re Central Illinois Light Co.*, ICC Docket No. 94-0040, 1994 Ill. PUC Lexis 577 (Order Dec. 12, 1994) ("*CILCO*"). In *CILCO*, the Commission included a pension asset in rate base, where the pension asset was created by cash contributions by the utility to the pension plan, as noted in *In re Northern Illinois Gas Co.*, ICC Docket No. 95-0219, 1996 Ill PUC Lexis 204 at \*20-21 (April 3, 1996). Peoples Gas' net pension asset reflects that it contributed \$15,278,614 to the pension plan during the test year and that North Shore's pension liability reflects that it contributed \$1,862,247 to the pension plan during the test year. NS-PGL Ex. LMK-3.0, at 3; NS-PGL Reply Br. at 29; Proposed Order at 32; NS-PGL BOE at 15. Also, ratepayers have benefited from the Utilities' test year contributions (as well as prior contributions) to these pension plans, because the pension expense levels in fiscal year 2007 were correspondingly reduced in the Utilities' *pro forma* adjustments. PGL Ex. SF-1.0, at 27; PGL Ex. SF-1.1, Sched. C-1, column [D], Sched. C-2, p. 1, line 15, and Sched. C-2.15; NS Ex. SF-1.0, at 25; NS Ex. SF-1.1, Sched. C-1, column [D], Sched. C-2, p. 2, line 15, and Sched. C-2.15; NS-PGL Init. Br. at 32; NS-PGL Reply Br. at 29-30; NS-PGL BOE at 15.

In addition, while not including the pension asset in rate base, the Commission approved recovery, at a debt rate of return, on a utility's recent contribution to a net pension asset in *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, pp. 28-29 (Order on Rehearing Dec. 20, 2006).

The recommended adjustments to the Proposed Order's treatment of the Companies' OPEB and pension asset/liability by Staff (Staff BOE at 9-11), the AG (AG BOE at 6-7 and Attachment A.II), and City-CUB (City-CUB BOE at 22-24), are not supported by past Orders nor are they reasonable and fair. Staff, the AG, and City-CUB all agree that rate base should be

reduced by the OPEB liabilities (*see also* Proposed Order at 35-36), but they disagree that the Utilities' contributions in the test year should offset such reduction because, in their opinion, ratepayers made the contributions. Their opinion does not warrant their positions.

As recognized by the Proposed Order, the “undisputed record” and “fairness” dictate that contributions made by a utility to its pension plans during the test year should be recognized if OPEB liabilities are also deducted from rate base. Proposed Order at 35. Despite Staff's claim to the contrary, and as detailed above, the undisputed evidence does show that the Utilities made these contributions, as was the case in *CILCO* and *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597, pp. 28-29 (Order on Rehearing Dec. 20, 2006), and that the corresponding reduction in pension expense will benefit ratepayers. Staff, the AG, and City-CUB cite no other past Order supporting such disparate treatment of OPEB liabilities as compared to pension assets and liabilities when the evidence clearly shows that a utility made contributions to its pension plan in the test year. Staff and GCI can cite no prior Commission Order that supports their attempt to distinguish the ComEd cases on the grounds that they reflected recent equity contributions versus what they characterize as contributions from a utility's “normal operating revenues”. AG BOE at 6; City-CUB BOE at 23; Staff BOE at 10.

This case is not like the 2004 and 1995 Nicor Gas rate cases cited by the AG (AG BOE at 6) where the Commission approved rate bases that reflected deductions for OPEB liabilities but did not incorporate pension assets. As Staff acknowledges, in both of those cases, the Commission found as a matter of fact that the pension assets were created by ratepayer-supplied funds. Staff Init. Br. at 18. The Commission expressly noted in the 2004 case that Nicor Gas acknowledged that it has made no pension plan contributions since the 1995 case. *In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779, p. 22 (Order Sept. 20, 2005) (“*Nicor Gas*

2005”). Similarly, the Order in the 1995 case indicates that the pension balance had gone from negative to positive since the utility’s 1987 rate case without any pension plan contributions. *In re Northern Illinois Gas Co.*, ICC Docket No. 95-0219, 1996 Ill. PUC Lexis 204, \*20 (Order April 3, 1996) (“*Nicor Gas 1996*”). The Commission’s Order in *Nicor Gas 1996* distinguished the Commission’s approval of inclusion of a pension asset in rate base in *CILCO*, on the grounds that there the utility, unlike Nicor Gas, had made pension plan contributions and the inclusion was not a contested issue. *Nicor Gas 1996* at \*22. Thus, the *Nicor Gas 2005* and *Nicor Gas 1996* Orders do not support Staff’s and GCI’s proposed adjustments, because the relevant facts as relied upon by the Commission are not the same, and the *CILCO* case supports inclusion.

AG and City-CUB further argue that if the Commission accepts the language in the Proposed Order, then the rate base addition for the test year contribution should be reduced by applicable deferred taxes. AG BOE at 7 and Attachment A.II; City-CUB BOE at 23-24. Neither the AG nor City-CUB cite any justification for this adjustment, other than it should be made simply because the Proposed Order reduces the deduction for accrued OPEB by applicable deferred taxes. Moreover, Staff does not take this position. The Commission should reject this eleventh-hour adjustment. If the Commission does not decide to (1) exclude both OPEB liabilities and Peoples Gas’ pension asset and North Shore’s pension liability from rate base; or (2) in the alternative, deduct the Utilities’ OPEB liabilities from rate base but include Peoples Gas’ pension asset and North Shore’s pension liability in rate base (NS-PGL BOE Exceptions at 12-13), then it should approve the Proposed Order on this subject and reject Staff’s and GCI’s Exceptions other than Staff’s Exception relating to the double-count of North Shore’s pension contribution.

### **III. OPERATING EXPENSES**

#### **C. Contested Issues**

##### **1. Storage Expenses**

###### **a. Crankshaft Repair Expenses (PGL)**

The Proposed Order, consistent with the evidence, allows recovery on an amortized basis over four years of the \$546,000 of prudent, reasonable, and necessary test year operating expenses that were incurred by Peoples Gas for repairing a crankshaft at Manlove Field, i.e., \$136,000 is to be included in the revenue requirement (one fourth of \$546,000, rounded down). Proposed Order at 49-50. Staff's Exception calling for Peoples Gas to be denied any recovery at all of these expenses (Staff BOE at 12-15) lacks merit and should not be adopted.

As the Proposed Order correctly finds, it is undisputed that the expenses in question were prudent, reasonable, and necessary, and that they occurred during the test year. Proposed Order at 49. Staff's BOE (at 12) expressly confirms that Staff does not dispute those factual findings.

Staff's position instead is based on the view that, because these were unusual and relatively large expenses that are not expected to recur, rather than being amortized over four years, Peoples Gas should simply be expected to bear the expenses, regardless of their being prudent, reasonable, and necessary and their occurring in the test year. *See* Staff BOE at 12-15.

The principle is long-established that rates "must allow the utility to recover costs prudently and reasonably incurred." *Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 121 (1995). Staff's position in effect would create an exception to that principle, along the lines of "except if the utility incurs a significant prudent and reasonable expense that is unlikely to recur, then the utility should have to bear the expense and should be barred from recovering it through rates". There is not a legal basis for such an exception to that principle,

and it is not reasonable or fair from a ratemaking or public policy perspective. Staff's view essentially is that a utility should be an insurer, on behalf of customers, at no cost, as to significant, non-recurring expenses. Also, Staff's view is likely to create perverse incentives for the utility, in instances where incurring the expense is in the interests of customers but is not required in order to provide safe, adequate, and reliable service. The Commission should not adopt Staff's view.

GCI's witness proposed the four-year amortization period for these expenses, which Peoples Gas accepted, thereby reducing the amount in the revenue requirement from \$546,000 to \$136,000. GCI Ex. 2.0, at 32-33; NS-PGL Ex. SF-2.0, at 5; NS-PGL Ex. SF-2.6P, page 3, Column [E]. GCI's witness did not change his recommendation in his rebuttal (GCI Ex. 5.0), although Staff correctly notes that GCI's witness, in a discovery response, conveniently expressed some support for the argument for complete denial of these expenses. Staff BOE at 12-13.

Peoples Gas, moreover, made the point that given the span of its operations, it is likely to experience different non-recurring events that result in expenses each year. NS-PGL Ex. SF-2.0 at 12. Staff now complains in its BOE that Peoples Gas did not provide details of other non-recurring events (Staff BOE at 14), apparently trying to suggest that its possible that a utility with 840,000 customers, a service territory of 228 square miles, 1,540 employees, 4,025 miles of distribution mains, and 425 miles of transmission lines (Proposed Order at 7-8) might not have any other unusual or non-recurring expenses from year to year. That is not a credible complaint. Nor is it timely. Staff's witness, unlike Staff's BOE, when responding to the testimony from Peoples Gas on the subject of the normality of different non-recurring events from year to year, did not dispute that Peoples Gas has other non-recurring events that lead to expenses each year.

He simply adhered to the view that this particular expense was so unlikely to recur that it should be disallowed. Staff Ex. 23.0, at 19-20. Staff's Exception lacks merit and should not be adopted.

## **2. Customer Accounts Expenses (Collection Agency Fees)**

The Proposed Order correctly rejects, based on the evidence, Staff's proposal to adjust downward the amount of collection agency fees included in the Utilities' revenue requirements. Proposed Order at 53. Staff's primary Exception here addresses not the merits but, instead, asks that, if the Commission agrees with the Proposed Order on this subject, then certain language changes be made. Staff BOE at 15-16. The Utilities believe that the existing language, which rejects and is critical of Staff's specious positions here, is accurate. However, in the interests of narrowing the issues, as long as the outcome of this issue is not changed, the Utilities will not take a position as to Staff's primary proposed language changes.

Staff's BOE also includes one lengthy sentence recapitulating its past erroneous claims on this subject, but it does not actually present any meaningful discussion of the merits, and instead presents, in the alternative, proposed language simply changing the outcome of this issue. *See* Staff BOE at 16-17. The Proposed Order's rejection of Staff's position is the only result that is consistent with the evidence, for the several reasons identified by the Proposed Order. Peoples Gas and North Shore have provided extensive, detailed evidence and argument showing that the levels of collection agency expenses in their revenue requirements are the normal levels that are to be expected during the period in which the rates being set will be in effect, that this is consistent with the Gas Charge settlement, and that Staff's proposal seeks without any legitimate justification to reduce the levels of these expenses far below the normal levels. *See* NS-PGL Init.

Br. at 42-44; NS-PGL Rep. Br. at 37-39. Staff's alternate Exception lacks merit and should not be adopted.

**3. Administrative & General Expenses**

**a. Injuries and Damages Expenses**

The Proposed Order, correctly based on the evidence, rejected Staff's proposed adjustments, seeking to adjust injuries and damages expenses based on a novel complicated formula using the ratio of accruals and payments over a five year period times the accruals in the test year. Proposed Order at 56-57. The Proposed Order found that the need for normalization was never shown in the first place (*id.* at 57), and that, in any event, Staff's proposed methodology was arbitrary and unwarranted, particularly when choice of a four year or three period would have resulted in increases, not decreases, in these expenses (*id.* at 56-57). Staff now complains that the Proposed Order made the inclusion of data from the first year of its five year period, 2002, "the issue" (Staff BOE at 18), conveniently ignoring that the Proposed Order found that normalization was never justified in the first place. In any event, Staff's proposed adjustments are without merit, as the Proposed Order found.

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. NS Ex. SF-1.0, at 18-20; NS Ex. SF-1.1, Sched. C-1, lines 13-14; Sched. C-2. Peoples Gas appropriately used its test year level, adjusted for a highly unusual credit recorded in fiscal year 2006 relating to a major claim that occurred in fiscal year 2002. PGL Ex. SF-1.0, at 19-21, 23, 31; PGL Ex. SF-1.1, Sched. C-1, lines 13-14, Sched. C-2, p. 2, line 30, and Sched. C-2.3.

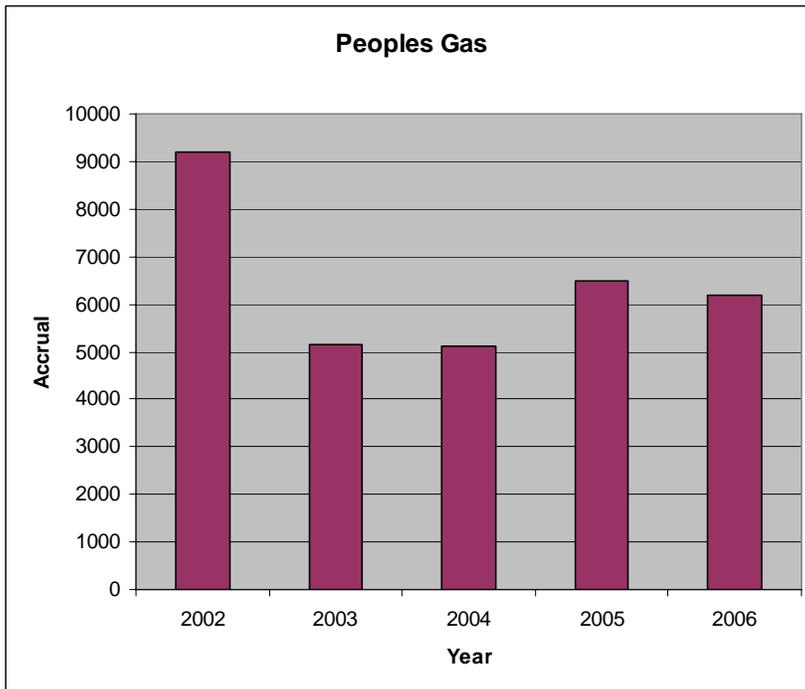
Staff previously claimed that: "Since the annual accruals can vary greatly from one year to the next, it is more appropriate to normalize the expense for ratemaking purposes." Staff Init.

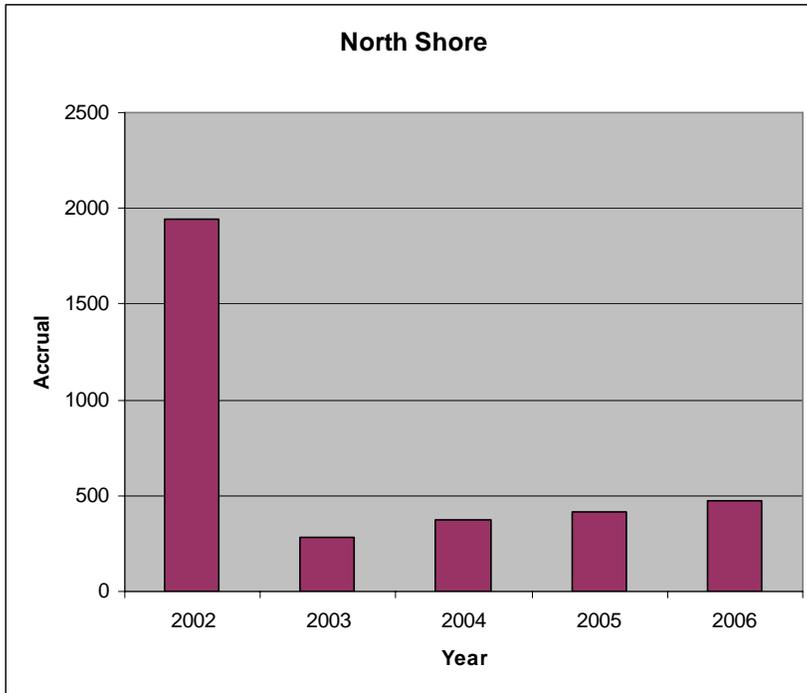
Br. at 32. Staff now argues that it chose to propose normalizing using a five year period based on *In re Central Illinois Light. Co., et al.*, ICC Docket Nos. 06-0070, 06-0071, 06-0072 Cons., pp. 48-49 (Order Nov. 21, 2006) (“*CILCO 2006*”). Staff BOE at 18. Both contentions are insufficient, because neither shows, based on the facts of the instance proceeding, that normalization is warranted here in the first place.

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

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

That data results in the following charts:





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

Moreover, Staff’s position, calling for normalizing the level of injuries and damages expenses, is inconsistent with Staff’s position, which calls for using an abnormally low test year value for collection agency fees, discussed earlier in this Reply Brief on Exceptions.

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

- (1) calculate the five year average of the accruals for these expenses over the period of fiscal years 2002 through 2006,
- (2) calculate the five year average of actual payouts over that period,
- (3) divide the latter by the former to develop a percentage, and
- (4) multiply that percentage times the fiscal year 2006 accrual to obtain the allowed level to be included in the revenue requirement.

See Staff Ex. 16.0, Schedules 16.2 P and 16.2 N.

Staff's witness cited *CILCO 2006*, but there, Staff looked at five years of data, and then discarded, in each instance, data from one year that Staff considered unrepresentative, resulting in Staff's proposing four-year averages. Consistency of proposals on Staff's part would have resulted in Staff not using the fiscal year 2002 data here. Staff claims it has not been shown that fiscal year 2002 is an "outlier" (Staff Init. Br. at 33; see also Staff BOE at 17-21), but the data above refute that claim.

Staff argues that the Proposed Order erred by focusing on the accruals data and not the payments data (Staff BOE at 18), but that argument lacks merit. It is the exceptionally high accruals in 2002, shown above, that resulted in the ratio of payments to accruals that drives Staff's proposed adjustments. Were it not for the exceptionally high accruals in 2002, the results would go in the other direction. Under Staff's methodology, had Staff chosen a four-year period (i.e., excluded the 2002 data) or a three-year period, then it would have generated higher levels of these expenses, not lower levels, for each utility. NS-PGL Ex. LMK-3.0, at 5. Staff's claim that its position somehow is validated "over time" (Staff BOE at 20) simply has it wrong. Staff's proposal is driven by the 2002 accruals. Indeed, Staff itself observes that 2002 "is noticeably different" from all the other years (Staff BOE at 20), although Staff illogically contends that that somehow supports normalization and using that year in the average. Staff offers only rank speculation, without any evidentiary citation, that future years might experience levels "just as noticeably different". Staff BOE at 20-21. There is no valid factual basis for Staff's arbitrary proposed disallowances.

Staff argues that *CILCO 2006* supports Staff's use of the five-year period (Staff BOE at 18), but Staff did not provide the data that was used in that case to determine that

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

**b. Incentive Compensation Expenses**

The Utilities should be allowed to recover all test year incentive compensation costs and expenses, for several reasons proven in detail by the evidence in the record and discussed in detail in prior briefing. NS-PGL Init. Br. at 47-53; NS-PGL Reply Br. at 43-47; *see also* NS-PGL BOE at 18-19. Thus, given the evidence, the Proposed Order correctly allows recovery of certain minimum costs and expenses, i.e., the amounts actually paid out in relation to the test year on operational metrics only under the "TIA Plan" and the "IPB Plan" (discussed below), but it errs in accepting GCI's and Staff's erroneous and unreasonable proposals to disallow other amounts. The complete disallowances proposed by Staff, City-CUB, and the AG in their respective Briefs on Exceptions go in the wrong direction. They are sharply contradicted by evidence in the record establishing that the Utilities are entitled to recover, at a minimum, the amounts already approved in the Proposed Order.

The specifics of the incentive compensation programs at issue, and the arguments for recovery of all test year amounts thereunder, have been fully discussed in the Utilities’ Initial Brief at 47-53 and their Reply Brief at 43-47, and they will not be repeated in full here. In brief, with regard to all of the Plans, the Utilities have demonstrated that the Plans are prudent and reasonable, and no witness has ever challenged that fact. *E.g.*, NS-PGL Ex. JCH-1.0, at 3-4. The Utilities also have demonstrated that the Plans are necessary to attract and maintain a sufficient number of high-quality employees — again, no witness has ever challenged that fact. *E.g.*, NS-PGL Ex. JCH-1.0, at 3. Finally, the Utilities have shown that the Plans resulted in tangible benefits to ratepayers, including but not limited to reduced O&M expenses, which results in reduced revenue requirements. NS-PGL Ex. JH-FV-2.0, at 6. The proposed disallowances thus contravene the established principle that rates “must allow the utility to recover costs prudently and reasonably incurred.” *Citizens Utility Bd. v. Illinois Comm. Comm’n*, 166 Ill. 2d 111, 121 (1995).

The 2006 Team Incentive Award (“TIA”) plan applied to non-officer, non-union employees. NS-PGL Ex. JCH-1.0, at 4. The performance measures under the TIA plan were 55% “financial” and 45% “operational” as Staff and the Commission have used those terms. *Id.* at 4:76 – 5:80. The “operational” performance measures consisted of a 25% weighting for controlling O&M expenses and a 20% weighting for customer satisfaction criteria (10% based on the number of calls to the Utilities’ call centers and 10% based on the ranking of the Utilities’ Gas Charges compared with those of six other Illinois utilities.) *Id.* at 4-5. The Utilities in prior briefing demonstrated, in detail, that Staff’s attempts to deny that 45% of the measures were operational are not correct, and Staff actually admitted that the Call Center metric benefits customers. NS-PGL Ex. JH-FV-2.0, at 5-7. Accordingly, while complete recovery of the entire

\$1,642,847 paid out, \$1,502,584 by Peoples Gas and \$140,253 by North Shore (\$1,607,568 had been accrued, \$1,465,444 by Peoples Gas and \$142,124 by North Shore), under the TIA plan (NS-PGL Ex. LK-2.0, at 9 (dollar amounts)) is appropriate, at a minimum, as found by the Proposed Order, Peoples Gas should recover the \$1,009,240, and North Shore should recover the \$94,204, that they paid out under the operational measures. NS-PGL Ex. JH-FV-2.0, at 7.

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

Staff argues that the Utilities should not be allowed to recover any incentive compensation expenses. With respect to the TIA Plan, Staff asserts that “the array of measurement components included within the TIA Plan allows the incentive criteria to change

from year to year.” Staff BOE at 22. Staff further argues that the TIA Plan and the IPB Plan are both “discretionary,” because, according to Staff, the rates could include the cost of a Plan for which the Company incurred no expense. Staff BOE at 23. Finally, Staff argues that the Utilities have not demonstrated that these two Plans provide benefits or cost savings to ratepayers. *Id.*

Staff’s arguments fail on every count. The Utilities have demonstrated, through uncontradicted evidence, that their incentive compensation programs will contain comparable metrics going forward. NS-PGL Ex. JCH 1.0, at 9-11. Further, the history of payouts relative to accruals demonstrates that the Utilities have incurred incentive compensation expenses and will continue to do so in the future. NS-PGL Ex. JCH-1.0, at 9. Finally, the Utilities have repeatedly demonstrated that their incentive compensation programs benefit ratepayers through increased productivity, higher quality work, reduced expenses, and increased customer satisfaction. *E.g.*, NS-PGL Ex. JCH-1.0, at 3; NS-PGL Ex. JH-FV-2.0, at 6.

City-CUB also argues that the Commission should completely disallow recovery of the Utilities’ incentive compensation costs and expenses. City-CUB asserts that the Proposed Order incorrectly allows recovery of amounts under the TIA and IPB Plans simply because the Plans “*might* benefit ratepayers” City-CUB BOE at 25 (emphasis in original). City-CUB further argues that the Utilities have failed to demonstrate any benefit to ratepayers. *Id.* Both of these arguments are disingenuous. Again, the Utilities have shown that their incentive compensation programs have resulted in tangible benefits to ratepayers and will continue to result in such benefits in the future.

The AG concurs with Staff and City-CUB that the Utilities should be denied recovery for all incentive compensation costs and expenses. The AG argues that the Utilities failed to show

that their incentive compensation programs reduced expenses or created efficiencies in operations. AG BOE at 8. That is simply untrue. The Utilities have demonstrated that their incentive compensation programs were a contributing factor in their reduction of O&M expenses below target levels. NS-PGL Ex. JH-FV-2.0, at 6.

The AG also has raised, for the first time in its Brief on Exceptions, an objection to the Utilities' recovery of amounts actually paid out under the IPB Plan, as opposed to the amounts accrued. AG BOE at 8-9. That argument is too little too late, as well as inconsistent and arbitrary. As an initial matter, the AG failed to raise this argument in its previous briefs, despite being on notice that the Utilities, in the alternative, at a minimum, expressly had requested recovery for the amounts actually paid out under the IPB Plan in both their Initial Brief and their Reply Brief. *See* NS-PGL Init. Br. at 47; NS-PGL Reply Br. at 47.

Moreover, the AG's argument demonstrates, yet again, that there is little consistency (or logic) to its arguments regarding incentive compensation expenses. The AG does not object to the Utilities' recovery of amounts paid out for operational expenses under the TIA plan, yet it opposes recovery of the amounts paid out under the IPB plan, insisting that such a recovery will result in "a greater IPB allowance in the revenue requirements than the Companies have sought to recover." AG BOE at 8. Such an approach is inconsistent and illogical, as well as simply incorrect. First, it applies opposing theories of recovery to the TIA and IPB Plans for no discernable reason. Second, it ignores the fact that the Utilities, from day one, have requested recovery of the amounts actually paid out under the IPB plan, as an alternative minimum. Finally, it fails to acknowledge that the Utilities already have paid out the amounts under both Plans. If the Commission feels that it is required to expressly address this new issue, then it should add the following sentence or a sentence to similar effect to the Commission Analysis and

Conclusion section: “The Commission specifically rejects the AG’s alternative proposal that the Utilities’ recovery under the IPB Plan be limited to the amounts accrued under that Plan.”

The Utilities have met their legal burden on the issue of recovery of incentive compensation by demonstrating that the Plans are reasonable and prudent, are necessary to attract and retain quality workers, as well as resulting in other tangible benefits to ratepayers, including controlling O&M expenses and customer satisfaction. Accordingly, the Commission should modify the Proposed Order to allow recovery of the full amount of incentive compensation costs and expenses incurred by the Utilities relating to the test year. In the alternative, the Commission should reject Staff’s, City-CUB’s and the AG’s proposed disallowances for the IPB and TIA Plans and approve the minimum amounts provided for in the Proposed Order.

#### **4. Invested Capital Taxes**

The Proposed Order correctly concludes, based on the evidence and rejecting GCI’s speculation, that: “The Commission accepts Staff’s and the Utilities’ proposal regarding the calculation of invested capital taxes. We are not persuaded by the bases for the GCI’s proposed disallowances. There is no factual matter in dispute. In the end, there is no evidence in the record to support GCI’s suggestion that an increase to operating income could lead to an increase in dividends.” Proposed Order at 70. City-CUB, however, still wants the Commission to alter the calculation of Invested Capital Taxes, a routine item in a rate case, by rejecting the portion associated with the approved rate increase amounts, based on GCI’s speculation that increased revenues might lead to an increase in dividends that alters the Utilities’ capital structures (City-CUB BOE at 27-30), even though the capital structures are an uncontested issue (Proposed Order at 76). City-CUB’s Exception lacks merit and should not be adopted.

City-CUB's central argument is that the Proposed Order's recommendation on this issue is based on speculation. City-CUB BOE at 27-30. That is ironic, because it is City-CUB's proposed disallowances here that are based on speculation.

To begin with, apart from the entirely speculative objection on the part of GCI, discussed below, there is no dispute that invested capital taxes need to be recalculated based on the final approved rate increases (the increases in base rate revenues) when setting the Utilities' final approved revenue requirements, and there is no dispute over how to perform those calculations. *E.g.*, NS-PGL Ex. SF-2.0, at 15; NS-PGL Exs. SF-2.13P and 2.13N; Staff Cross Fiorella Exs. 1 and 2.

GCI witness Mr. Effron proposed, on two grounds, to disallow the Utilities' *pro forma* adjustments reflecting the impacts on invested capital taxes of their proposed rate increases. His first ground, essentially, is the point that invested capital taxes need to be recalculated based on the final approved rate increases. *See* GCI Ex. 2.0, at 34-35. As noted above, the Utilities, Staff, and the Proposed Order agree that there needs to be such a recalculation. That does not warrant rejecting the *pro forma* adjustments, however, because rejection would assume that there will be no approved rate increases at all, a result that is inconsistent with the parties' positions and the Proposed Order. Staff agrees with the Utilities' position. *See, e.g.*, Staff Ex. 1.0, at 14-15.

Mr. Effron's second ground is his raw speculation that "it is entirely possible that an increase to operating income would lead to an increase in dividends. To the extent that any additional earnings are paid out in dividends, there will be no increase to retained earnings as a result of the increase in operating income." GCI Ex. 2.0, at 35. Mr. Effron cited no factual basis for his speculation. There is none. Mr. Effron's proposal to deny recovery of invested capital taxes on the basis of such speculation is improper. *E.g.*, *Ameropan Oil Corp. v. ICC*, 298 Ill.

App. 3d 341, 348 (1st Dist. 1998) (“speculation has no place in the ICC’s decision or in our review of it.”); *Allied Delivery System, Inc. v. Illinois Commerce Comm’n*, 93 Ill. App. 3d 656, 667 (1st Dist. 1981) (“The speculation indulged in by the Commission is clearly an unsatisfactory and unacceptable basis for its decision.”); *In re Commonwealth Edison Co.*, ICC Docket No. 99-0117, p. 105 (Order, August 25, 1999) (“we will not make an adjustment that is speculative....”).

City-CUB has it completely backwards, therefore, when they complain that the Utilities failed to disprove Mr. Effron’s speculation. City-CUB’s argument is contrary to the law regarding speculation, discussed above, and also to the law regarding the burden of proof. A utility bears the burden of proof that its proposed rates are just and reasonable, 220 ILCS 5/9-201(c), but once it makes out a *prima facie* case, the burden of going forward with the evidence shifts to the other parties that challenge its costs.

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

*Illinois Bell Tel. Co. v. Illinois Commerce Comm’n*, 327 Ill. App. 3d 768, 776 (3d Dist. 2002). The law also is clear that the utility does not bear the burden of proof on all the issues that conceivably are relevant to the reasonableness of its rates, nor is it required in its direct case to anticipate and disprove the objections that opposing parties might make. *City of Chicago*, 133 Ill. App. 3d at 442. The Utilities were not required to disprove GCI’s speculation. The Commission should calculate the final level of invested capital taxes, in the manner shown by the Utilities and agreed to by Staff, based on the final approved rate increases, as is concluded by the Proposed Order.

#### **IV. RATE OF RETURN**

Only Staff and City-CUB addressed the Utilities' rate of return in their BOEs. Staff raises only two minor issues with the Proposed Order's wording, neither of which are objectionable to the Utilities. Staff BOE at 28-29. City-CUB raise only three substantive issues on the Utilities' cost of equity, to which the Utilities reply below. City-CUB BOE at 31-39.

This state of affairs is troubling to the Utilities because the Proposed Order adopts the Staff position on cost of equity in its entirety. The Utilities in their BOE provided an extensive analysis of the Proposed Order's cost of equity provisions and supported several modifications to the Staff position as adopted by the ALJs. NS-PGL BOE at 20-37 & Attachment 1; NS-PGL Exceptions 12-14, at pp. 22-33. As the result, Staff and City-CUB will effectively have the last word on cost of equity in this case, even though the ALJs adopted the Staff position and propose to set the Utilities' rates of return at levels lower than those established for any Illinois gas utility in over 30 years.

##### **A. Capital Structure (Uncontested)**

The Staff and City-CUB BOEs reconfirm that the Utilities' capital structures are uncontested and properly reflected in the Proposed Order. The Utilities have no objection to the additional language requested by Staff regarding its position set forth at page 28 of its BOE.

##### **C. Cost of Common Equity**

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

Only City-CUB raise any substantive issues with respect to the Proposed Order's rate of return provisions. City-CUB challenge three aspects of the ALJs' proposed adoption of the Staff position on rate of return: (1) the calculation of the market risk premium in the CAPM model, (2) the averaging of disparate financial market cost of equity model results, and (3) the impact on the

Utilities' cost of equity of the Commission's approval of the Utilities' proposed decoupling and uncollectible riders. The Utilities address each of these challenges below.

**There Is Nothing "Parochial" About Staff's or the Utilities' Calculation of the CAPM Market Risk Premium**

City-CUB persist in characterizing theirs as the only "unbiased" positions on cost of equity. The Utilities thoroughly debunked this characterization in their Post-Hearing Reply Brief (at 49-53), demonstrating that City-CUB's positions are fraught with subjectivity and the intent to develop the absolute lowest cost of equity for the Utilities.

Here again, City-CUB assert that their cost of equity witness' CAPM risk premium is based on "empirical research from independent academics" of "a universal market characteristic," and therefore must be taken instead of the "parochial" CAPM premiums calculated by the Staff and Utility cost of equity witnesses. City-CUB BOE at 32. To the contrary, it is City-CUB's so-called "unbiased research" that must be questioned. As Ms. Kight-Garlich testified, the research cited by Mr. Thomas "represents various academics' opinions of the equity risk premium investors should expect, which is not necessarily the same as what the investors truly are expecting." Staff Ex. 18.0, at 20 (emphasis added). It is, of course, the equity risk premium that investors are expecting that the financial market models are designed to determine. "The CAPM states that the expected rate of return on a security is determined by a risk-free rate of return plus a risk premium which is proportional to the non-diversifiable (or systematic) risk of a security." PGL Ex. PRM-1.13G, at 1 (emphasis added). Thus, the "unbiased research" cited by Mr. Thomas is simply irrelevant to the issue at hand.

City-CUB characterize Staff's and the Utilities' market risk premiums as "parochial" and "local," as if their premiums were specific to the Utilities. City-CUB BOE at 32, 33. Not true.

Mr. Moul based his risk premium on forecasts of capital appreciation and dividend yield from the Value Line Investment Survey Summary and Index, which tracks 1,700 stocks, as well as the S&P 500 Composite Index. PGL Ex. PRM-1.0 REV, at 39-40. He also considered the historical rates of return published by Ibbotson Associates for all stocks for the period 1926-2005. *Id.*, at 40. Ms. Kight-Garlich based her expected risk premium on a DCF analysis of the firms comprising the S&P 500 Composite Index, dividend information from S&P's Security Owner's Stock Guide, and market prices and growth rate estimates from Zack's. Staff Ex. 6.0, at 11-12. There is nothing parochial, local, idiosyncratic or biased about these market risk premium determinations, as City-CUB variously claim.

If adopted, the City-CUB position on the CAPM risk premium would fix the premium based on studies of what investors should expect unless and until Mr. Thomas found new studies that he preferred to cite. Until then, the CAPM cost of equity would vary only with the risk-free rate of return. That is contrary to the CAPM model, which is based on two variables, the risk-free rate of return based on long-term Treasury bond yields and the market premium based on investor expectations for overall stock market returns. PGL Ex. 1.0 REV, at 38-40; PGL Ex. PRM-1.13G, at 2-3, 5. Ms. Kight-Garlich agrees with Mr. Moul that "the relationship between the returns of the stock market and U.S. Treasury bonds is not stable over time." Staff Ex. 18.0, at 20. City-CUB's approach would ignore half of the cause of this instability and must be rejected as wholly inconsistent with the CAPM methodology.

### **City-CUB Properly Criticize Staff's Averaging of Disparate Financial Model**

#### **Results**

The Utilities agree with City-CUB that the averaging of disparate results from the financial market models does not create one "valid" result. City-CUB BOE at 33. The Utilities

made the same point in their BOE (at 27). City-CUB also echo the Utilities in stating that “the wide variance among [disparate results] is a strong indication that some of the estimates were not accurate.” City-CUB BOE at 34. As the Utilities have shown, it is Staff’s DCF that is not accurate. Something is amiss when a financial market model generates costs of equity that approach and even fall below the cost of utility debt. NS-PGL BOE at 27-28. City-CUB’s argument supports the Utilities’ position that the Commission should disregard Staff’s DCF result.

City-CUB, however, paint with too large a brush in arguing that the financial market model results of both the Staff and Utility cost of equity witnesses are too disparate to average. That is simply not the case. City-CUB agrees with the Utilities that the 311 basis point spread between Staff’s unadjusted DCF (8.23%) and CAPM (11.34%) results are too widely apart to average and to set the Utilities’ market cost of equity at the result (9.79%). City-CUB’s similar criticism of the Utilities’ DCF and CAPM results is not well founded. The difference between the Mr. Moul’s unadjusted DCF and CAPM results is only 178 basis points, and the difference between his results adjusted for financial leverage and flotation costs is only 230 basis points. NS-PGL BOE, Attachment 1. City-CUB’s criticism therefore does not apply to Mr. Moul’s DCF and CAPM results.

City-CUB repeats its assertion, thoroughly refuted by Staff and the Utilities, that the DCF model provides an “objective” cost of equity estimate, while the other models are “subjective” and therefore “supplemental” to the DCF. City-CUB BOE at 34, 35. The truth is that the application of all of the models involves the analyst’s judgment in choosing the various inputs to the models from a plethora of financial data. NS-PGL Reply Br. at 50. City-CUB itself has previously admitted that that “no estimation methodology is entirely objective.” City-CUB Init.

Br. at 36. There are just as many subjective choices involved with applying the DCF model (e.g., the measurement of the price, the quarterly vs. annual form of the model, the growth rate) as with the other financial market models. For example, Mr. Thomas' inappropriate attempt to influence the result of his DCF model through the use of lower, "internal" growth rates is well documented by both Staff and the Utilities. NS-PGL Reply Br. at 51.

**There is No Basis For Any Adjustment to the Utilities' Cost of Equity Associated with the Utilities' Proposed Decoupling and Uncollectible Riders**

City-CUB argue that any utility proposal for a rider that decouples a utility's revenue from the influence of a variable that is beyond the utility's control, such as weather, must be accompanied by a proposal to lower the utility's return on equity. City-CUB assert that the lack of such a proposal by the Utilities means that the Commission must accept City-CUB's adjustment based on weather insurance policies previously purchased by the Utilities' parent. City-CUB BOE at 35-37.

In staking out this position, City-CUB simply assume that such riders affect a utility's cost of equity and that the effect is necessarily to reduce that cost. The record falls far short of establishing this prerequisite to City-CUB's proposal. As the Proposed Order notes, Mr. Moul testified that a utility's cost of equity is not affected by company-specific, "un-systemic" risks like the weather or the existence of decoupling mechanisms in the utility's rates. NS-PGL Init. Br. at 87. Neither Staff nor City-CUB presented any basis in financial theory for their shared position that approval of the decoupling riders should result in a reduction in the Utilities' cost of equity. To the contrary, the fact that most of the companies comprising the proxy group already have decoupling mechanisms, yet have risk similar to the Utilities' risk, proves Mr. Moul's opinion. *Id.*, at 89.

City-CUB claim that the ALJs improperly demand a demonstration that the approval of decoupling riders would change the Utilities' risk relative to the proxy group's collective risk. City-CUB BOE at 35-36. City-CUB characterize the Proposed Order as expressing only a "preference" for such a demonstration. In reality, the ALJs propose the flat rejection of Mr. Thomas' "proxy" analysis: "[T]he Commission believes that the cost of common equity analysis is an integrated process and great care should be taken in making ad hoc adjustments to the cost of common equity. Given that both the City/CUB and Staff witnesses performed cost of equity analyses on a proxy utility sample, any adjustment to the computed cost of equity would more properly reflect any difference in risk between the proxy utility sample and the target utility company." Proposed Order at 94. Such a rejection is consistent with the evidence, for all of the reasons that the Utilities have previously identified, not the least of which is that Mr. Thomas wrongly assumes that the value of an insurance policy is equal to its maximum payout. NS-PGL Post-Hearing Init. Brief at 89.

Finally, City-CUB mischaracterizes the Proposed Order as "implicitly acknowledg[ing] that some adjustment would be required for the change in riskiness revenue assurance riders would cause." City-CUB BOE at 36. City-CUB argue that this means any rate increase approved by the Commission with decoupling or uncollectible riders would be "inappropriate" and "unlawful" without an ROE adjustment. *Id.* City-CUB grossly exaggerate. After rejecting City-CUB's "proxy" methodology based on a Peoples Energy Corporation weather insurance policy, the Proposed Order states: "While the Commission does not dismiss the intention underlying Staff's and City/CUB's recommendation, the record does not contain sufficient information to justify and quantify the type of adjustment that those parties advocate." Proposed

Order at 94 (emphasis added). That is hardly the language of acknowledgment, much less a finding that approval of the riders would require an adjustment to the Utilities' cost of equity.

For these reasons, the Commission should reject City-CUB's proposed modifications to the Proposed Order as it relates to the Utilities' cost of equity.

**E. Weighted Average Cost of Capital**

**1. Peoples Gas and 2. North Shore (combined)**

The Utilities' weighted average cost of capital should be modified as provided in the Utilities' BOE (at 37).

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

**A. Overview**

As the Commission is aware, and as Staff's Brief on Exceptions goes to considerable lengths to remind the Commission, this is not the first Docket in which the Peoples Gas Hub was an issue. The Hub was also a topic of considerable discussion in ICC Docket No. 01-0707, Peoples Gas' 2001 gas reconciliation case. In that Docket, the Commission criticized Peoples Gas' accounting procedures for its Hub operations, and ordered Peoples Gas to change them. *Illinois Commerce Comm'n on Its Own Motion v. Peoples Gas Light and Coke Company*, ICC Docket No. 01-0707, p. 8 (Order March 28, 2006) ("Final Order"). For example, the Commission found that Peoples Gas was improperly charging Hub costs to ratepayers, but not giving them the corresponding benefit. To remedy this, the Commission ordered Peoples Gas to credit Hub revenues to customers through the PGA. Final Order at 8. The Commission also ordered Peoples Gas to refund \$100,000,000 to ratepayers, and stated that its confidence in Peoples Gas' management was shaken. Final Order at 140.

Since the entry of that Order in March, 2006, much has changed at Peoples Gas. There is no dispute that Peoples Gas has complied with the Commission's Order, and that Hub revenues now flow through the PGA to the benefit of customers buying company-supplied gas. Peoples Gas even has new owners.

Staff opposed the \$100,000,000 refund, which was part of a settlement. Final Order at 4, fn. 4. The Commission, however, approved the settlement. Staff felt that \$100,000,000 was not enough, and in the instant Docket, they seem determined to exact further punishment from Peoples Gas.

It is quite clear that it is further punishment that Staff seeks. As the Proposed Order found (at 113), Staff's argument is that Peoples Gas has injected too little base gas into its storage field, but Staff's proposal is that all of the base gas Peoples Gas *did* inject should be excluded from rate base. Staff justifies this paradox as punishment for the bad behavior found in ICC Docket No. 01-0707, and Staff warns that allowing Peoples Gas to recover its actual base gas would constitute a "reward" for such behavior.

Peoples Gas has accepted the results of ICC Docket No. 01-0707 and has turned the page on that part of its history. While the internal and external audits from that Docket continue, as the Commission ordered, it is not appropriate to mete out additional punishments for the same behavior, absent some new wrongdoing. Now under new ownership, Peoples Gas asks the Commission to judge its rate case not on the basis of punishment-versus-reward, but on the evidence of the actual items in its rate base, on which it is entitled to earn a fair rate of return. It is undisputed that Peoples Gas capitalized \$39,018,791.41 of base gas. That is the amount properly included in rate base.

**B. Staff's Hypothetical Extra Base Gas**

Staff's argument is not that the \$39 million of base gas on Peoples Gas' books is too much, and that some of it should be disallowed. Staff's argument is that Peoples Gas has far too little base gas – Staff suggests the real number should be over \$114 million (Staff BOE at 43), and that therefore Peoples Gas should recover *none* of the \$39 million on the books.

Here is Staff's calculation in a nutshell. Peoples Gas has expanded its working gas in storage at Manlove Field by 10.2 Bcf since the mid-nineties. With expansion of working gas comes additional base gas, and Staff has multiplied the 10.2 Bcf by a "historical ratio" of 4.44 Bcf of base gas for every 1.0 Bcf of working gas. So, 10.2 Bcf of working gas times 4.44 equals 45 Bcf of base gas. Yet Peoples Gas has actually only capitalized 7.88 Bcf of base gas, so Staff says Peoples Gas has put in far too little.

**1. Staff's "Historical Ratio"**

As the evidence in the record shows, and as the Proposed Order recounts, there are several problems with Staff's calculation that render it invalid. First, the "historical ratio" is not a valid way to predict base gas requirements for a new expansion of working gas. The record demonstrates that, during the early years of the development of Manlove Field, the base gas requirements were much higher than later on. PGL Ex. TLP-2.6. One reason for this is the complex geology of Manlove Field. It is true that when gas invades "virgin aquifer," a large portion, estimated at 56%, is trapped and becomes base gas. However, Manlove Field is large, has many injection wells, and has operated for many years, resulting in zones which, while not actively being utilized prior to the start of the Hub, were not virgin aquifer either. PGL Ex. TLP-1.0, at 4:71 - 84; NS-PGL Ex. TLP-2.0, at 10-12. Thus, the same expert report from 2003

that Staff cites (Staff BOE at 35), in a section entitled “Effect of Growing the Field by 1 Bscf/yr” states:

Growth results in better performance to a point, but there does come a point of diminishing returns. At some point growth gas will begin occupying virgin aquifer pore space. Previous estimates have been that 56% of this gas will be trapped and lost, and thus no longer “growth.” It currently appears that the reservoir gas saturation in the central portion of the field is improving. Very little of this gas is lost.

PGL Ex. TLP-1.1, at 37.

What Staff has consistently ignored is that Peoples Gas’ expansion of Manlove Field in connection with the Hub has been gradual. While this issue has been discussed at length in the testimony, the post-trial briefs, and the Proposed Order (at 101), Staff’s Brief on Exceptions continues to say that “the 10.2 Bcf expansion of Manlove immediately caused around 50% of that gas” to be lost. Staff BOE at 35. Staff also has a table on page 40 that shows a 30% leap in working gas from 1998 to 1999. These statements are at odds with the facts: as shown on NS-PGL Ex. TLP-2.8, column (a), the increase was gradual (and only 6.3% between 1998 and 1999). It therefore matches the discussion in the expert report quoted above, as opposed to one big expansion that pushes into virgin aquifer. Another problem with Staff’s table is that it only reflects capitalized injections. As Staff and the Commission know, in previous years Peoples Gas was expensing maintenance gas, and Staff’s Table 1 does not reflect 1.31 Bcf of uncapitalized base gas from 1999 and 2000. PGL Ex. TLP-2.8.

## **2. Normal Field Observations**

The second major problem with Staff’s 45 Bcf base gas number is that actual experience has shown the field to be working properly. The experts from Peoples Gas and Staff agreed that the proof is in the performance: the field operator watches field performance, and if it drops off, too little base gas has been injected. If field performance remains strong, the base gas injections

are sufficient. NS-PGL Ex. TLP-2.0, at 8-9; D. Anderson, Tr. 485-486. Peoples Gas has monitored the performance of Manlove Field, and found performance to be fine while injecting 3.5% base gas each year.

As discussed in the Proposed Order at page 101, the record contains an interesting demonstration of this effect. During a short period after repairs to the field's meters that measure injections, Peoples Gas inadvertently decreased its injections by what amounted to 0.6 Bcf. In only two seasons, Peoples Gas noticed a drop in field performance. When the injections were restored to 3.5%, field performance rebounded to normal.<sup>5</sup> If Staff were correct that Peoples Gas has under-injected by over 30 Bcf, then the effects on performance would be dramatic. But no such problems have been seen. NS-PGL Ex. TLP-2.0, at 9.

### **3. Illinois Power's Hillsboro Field**

Staff advances one new argument on base gas, but to no avail. Staff cites to a 1991 case involving Illinois Power's Hillsboro storage field, in which the expansion of that field involved a significant increase in base gas. But storage fields cannot be cited like case precedents. What happened at Hillsboro has nothing to do with Manlove, which Staff concedes is unique (Staff BOE at 38) and which Staff's Mr. Anderson (who previously operated Hillsboro, but never Manlove) conceded was significantly different from Manlove in many respects. D. Anderson, Tr. 467-468. Also, Illinois Power in that situation injected all the base gas as part of the initial

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<sup>5</sup> Given that this point was covered in Peoples Gas' testimony (NS-PGL Ex. TLP-2.0, at 7-8), Peoples Gas' Initial Brief (at 97 fn. 17), and again in Peoples Gas' Reply Brief (at 67), it is hard to believe that Staff, at the exceptions stage, would continue to state that "Peoples Gas has already greatly increased the percentage of maintenance gas retained by Manlove base gas injections, from 2% to 3.5%", and that this proves that base gas injections were insufficient. Staff BOE at 43-44. The record is absolutely clear and undisputed on this point: Due to a metering inaccuracy, when the meters indicated a 2% injection, the real amount was between 3.0% and 3.5%. NS-PGL Ex. TLP-2.5. After the meters were fixed, Peoples Gas began injecting a real 2.0% for a time, and only then saw field performance fall off. Once injections were raised again to 3.5%, field performance rebounded, and Peoples Gas has continued 3.5% injections since. NS-PGL Ex. TLP-2.0, at 7-8.

expansion (*In re Illinois Power Co.*, ICC Docket No. 91-0499, 1992 Ill. PUC Lexis 416 at \*6 (Order Oct. 21, 1992), whereas Peoples Gas has continuously injected base gas over a period of several years. Thus, the strained analogy to another field does nothing to refute the Proposed Order's finding that "Staff's arguments as well as inputs for its calculations rely on pure speculation that massive amounts of base gas into Manlove will be needed in the future." Proposed Order at 111.

#### **4. The Cost of Continuous Injections**

Staff's argument that the continuous injection of base gas increases the cost of base gas is purely an exercise in hindsight, not a true test of prudence. *See* Staff BOE at 43. Staff states that, if all base gas were purchased in year one, Peoples Gas would lock in year one prices. If the company continuously injects the gas, it has to pay the price for some of the gas in years two, three, four, and so on. It is true that the price of gas fluctuates, but it is not necessarily true that the price of gas will go up more than the time value of money. Staff's retrospective calculations, using 2006 prices, would have been impossible for Peoples Gas to perform in 1998. Staff's argument therefore does not comport with Illinois law. *Illinois Power Co. v. Illinois Commerce Comm'n*, 245 Ill. App. 3d 367, 375 (3d Dist. 1993) ("considering the knowledge available to Illinois Power management in December of 1980 . . . the evidence is not sufficient to support the finding that the January 1983 fuel load date was not prudent at the time it was established.").

Utilities are often put in situations where they need to decide between up-front expenditures versus the discounted cost of future expenditures. *See, e.g. Commonwealth Edison Co.*, ICC Docket No. 92-0221, pp. 22-23 (Order Oct. 18, 1995) (comparing alternatives based on present value of revenue requirements). Staff is in effect saying that Peoples Gas should have predicted that the price of gas would go up more than the capitalization rate. It is simplistic to

argue from a retrospective review of gas prices that buying smaller amounts of base gas over a period of several years is imprudent. In any event, Staff's argument does not support Staff's conclusion that 100% of base gas should be disallowed.

**C. Staff's "Cross-Subsidy" Argument**

Staff argues that the Hub is being cross-subsidized, and complains that the Proposed Order misstates Staff's position. Staff BOE at 45-46. However, it is difficult to understand Staff's position. The Hub is not uneconomic unless one accepts Staff's addition of the hypothetical 45 Bcf of base gas to the analysis, and, as discussed above and in the Proposed Order, that makes no sense. In any event, the Commission's Order in ICC Docket No. 01-0707 has already prevented any cross subsidy to Hub customers. The Commission ordered that third parties bear their share of the cost of base gas injected for their benefit. Final Order, p. 9, para. 11. The Commission further ordered that all Hub revenues be fully allocated to Peoples Gas' customers through the Gas Charge. *Id.* at 8. So long as the FERC-jurisdictional customers pay their fair share of the costs, and the money generated goes to customers (not Hub customers and not Peoples Gas' shareholders), there can be no cross subsidy. NS-PGL Ex. TZ-2.0, at 66. Though Staff argues that customers did not receive this benefit until after the Order in ICC Docket No. 01-0707, customers did receive the \$100,000,000 refund ordered in that Docket. The Proposed Order properly rejects Staff's argument.

**D. Extension of Manlove Field's Decline Point**

Staff devotes a short section of its Brief on Exceptions to attempting to refute the finding in the Proposed Order that the Hub extends the decline point of the storage field – the point during the winter withdrawal season at which the field can no longer sustain its maximum withdrawal rate. Staff BOE at 47-48. Peoples Gas' operational expert testified to this, and

backed it up with two studies admitted into the record. NS-PGL Ex. TLP-2.0, at 13-14; NS-PGL Ex. TLP-1.1; NS-PGL Ex. TLP-2.9. As the Proposed Order found, these studies were unchallenged in the evidence. Staff's main contention is that, in ICC Docket No. 01-0707, the Commission "definitively declared" that this was not the case. Staff BOE at 48. Staff has not read the Commission's Order with care, however. The Final Order in that Docket repeatedly states that the decline point *was* extended. This appears on pages 80, 88, 90, and 93. What the Commission found in that Docket was that there was no proof of a monetary benefit to customers of the extension of the decline point.

Whether or not there is a monetary benefit to customers, the operational benefit of extending the decline point of a storage field is quite clear. Peoples Gas has access to the full daily peak withdrawal capability of the field longer into the winter season, giving the utility more flexibility to respond to a late-winter cold snap. NS-PGL Ex. TLP-2.0, at 13. The Proposed Order's conclusions on page 112 are fully supported by the record.

**E. Hub Revenues Rate Design**

Vanguard filed an exception to the Proposed Order claiming that transportation customers should be entitled to a share of the Hub revenues that Peoples Gas receives for performing Hub Services. RGS also excepted to the Proposed Order, asserting that CFY customers also should be entitled to a share of Hub revenues. Peoples Gas notes that transportation customers currently receive a benefit from Hub revenues when they buy company-supplied gas. NS-PGL Ex. TZ-2.0, at 15. Peoples Gas does not take a position on the issue of whether transportation customers or CFY customers should receive a share of the Hub revenues. Peoples Gas is willing to dispose of these revenues as directed by the Commission as long as the Commission's direction is clear and unambiguous. However, if the Commission decides that

transportation customers and CFY customers should be entitled to share in Hub revenues other than in the manner they do today, Peoples Gas requests that it be able to develop a mechanism similar to what Peoples Gas understands Nicor Gas has in place, with appropriate modifications to fit within Peoples Gas' Rider 2.

## **VI. WEATHER NORMALIZATION – AVERAGING PERIOD**

Staff, in its Brief on Exceptions (at 65-66), joins the Utilities in urging the Commission to adopt a 10-year weather normalization period. Staff echoes the Utilities' rationale that it would make sense for Peoples Gas and North Shore to use the same averaging period as approved for nearby Nicor Gas (which actually uses a weather station inside the Peoples Gas service territory). Staff's suggestion, however, incorporates the Proposed Order's requirement that the Utilities use data through the most recent year, 2007. The record contains only the ten years ending September 30, 2006; fiscal year 2007 data was not available, and is not in the record. Also, the average number of heating degree days would be different than those used by the Utilities, requiring them to develop new billing determinants to put into effect the Commission's allowed revenues. The Utilities therefore prefer to use their original proposal.

GCI, during the course of this consolidated Docket, advocated using the old 30-year weather normal, which was thoroughly discredited in the evidence as discussed in the Proposed Order. GCI, in the Brief on Exceptions of City-CUB (at 41-44), have given up on the 30-year average, and now support the Proposed Order's novel 12-year average, which was never advocated by any party or witness. The Utilities' Brief on Exceptions (at 38-40) discusses the problems with a 12-year average. Like Staff's proposal, using 12 years of data through 2007 would require the development of new billing determinants based on data that is not in the Commission's record.

## **VII. NEW RIDERS**

### **B. Rider VBA and Rider WNA**

Exceptions in respect of Rider VBA were filed by the AG, City-CUB<sup>6</sup> and the Commission Staff. Essentially, neither the AG nor the Staff raised arguments that have not been urged extensively in their Initial and Reply Briefs in this proceeding. Further, the Utilities have previously addressed the arguments presented by AG and Staff in the NS-PGL BOE and in their opening briefs. Therefore, the Utilities will not burden the Commission with repetitive details in respect of the issues raised by the AG and Staff

Rather, the Utilities will simply summarize the flawed reasoning employed by the AG and Staff and refer the Commission to the record and briefs where the issues have been addressed comprehensively. In addition, the Utilities believe that the Exceptions urged by Staff and AG reflect an intransigence and refusal to acknowledge evolving change that is not constructive in the Commission's deliberation process and utility oversight in general.

Staff and the AG have flatly opposed each of the Utilities' proposed new riders (other than Rider EEP, as to the AG) for essentially the same reasons. At every stage of this proceeding, those parties have argued that the riders, including Rider VBA, are illegal under Illinois law because they violate prohibitions against single issue ratemaking, and retroactive ratemaking and are not in compliance with the Commission's test year regulations. The analyses offered by the AG and Staff, however, are flawed and misleading.<sup>7</sup>

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<sup>6</sup> City-CUB did not file independent Exceptions relating to Riders VBA, WNA, ICR, EEP or UBA. City-CUB merely adopted the AG's arguments and Exceptions as to those Riders.

<sup>7</sup> In the Proposed Order (at 133), the ALJs suggest that a broader consensus is desirable before adoption of decoupling. In a proceeding where the parties are forthrightly attempting to adopt responsible and fairly constructive positions, that might be a justifiable course of action. Here, however, such an approach would merely give Staff and the AG a veto power, because, as will be discussed below, they have evinced no willingness to adopt anything but a rigid and unyielding position regarding Riders VBA and WNA.

The AG and Staff attempt to seize upon the automatic adjustment feature of Rider VBA to argue that the rule against retroactive ratemaking and test year regulations are violated. These parties disingenuously argue that these rules are violated by the mere fact that collections from customers may change from month-to-month to recover a fixed Commission-established revenue requirement. If this position were correct, no automatic rate adjustment could ever be legal because, by definition, a rider always changes the amount collected. What is dispositive is that Rider VBA and Rider WNA are entirely consistent with the principles that Staff and the AG invoke, because the charges and credits in the rider will be defined in a specific manner approved by the Commission and set forth in a rate schedule established in a rate case in which the Commission applied test year prescriptions and adopted a revenue requirement, and with no ability, by reason of operation of Rider VBA or Rider WNA, for the utility to overcollect or undercollect the defined amount approved by the Commission.

Similarly, Staff's and the AG's single issue ratemaking claims are fictitious. Rider VBA creates no single issue ratemaking concern because the Rider VBA adjustments do not enable the Utilities to change the amount of base revenues that the Commission decision will have allowed them to collect through the volumetric charges involved in Rider VBA. Rider VBA is simply a mechanism which will allow the Utilities to actually collect the amount that the Commission will have established, *i.e.*, the portion of the approved revenue requirement that the Commission determined should be recovered through those charges. The same is true as to Rider WNA, except that it is limited to weather normalization. Neither Staff nor AG has properly analyzed

Rider VBA or Rider WNA under the legal rules they argue should apply and utilizing the actual facts of how the riders would operate.<sup>8</sup>

The essence and tone of the arguments asserted by Staff and AG is that any rider is contrary to Illinois law and should not be approved, even though riders have been uniformly applied by this Commission.<sup>9</sup> The Staff and AG imply that Illinois law is so inflexible that this Commission has little discretion in evaluating utility rate proposals that involve automatic rate adjustments. As the Utilities have strenuously argued and as set forth in the NS-PGL BOE, nothing could be further from the truth. This Commission possesses ample authority to review and approve riders under appropriate circumstances and Illinois law is not so rigid that riders must *per se* violate the single issue and retroactive ratemaking prohibitions or test year criteria. When the circumstances presented reflect reasonable and persuasive facts or policy that particular rate elements warrant treatment via an automatic adjustment, this Commission has not hesitated to exercise its lawful authority to implement riders.

In the case of Rider VBA, the Utilities presented considerable evidence that changing customer usage patterns and variability caused by weather and other factors have created circumstances in which the Utilities may under-recover or over-recover their Commission approved margin revenues from month-to-month or on an annual basis. Staff and the AG urge that the Utilities have not met their burden of proving the need for Rider VBA. The Staff and the AG's position is patently untenable. The record is rife with testimony and other evidence that

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<sup>8</sup> The rules against single issue and retroactive ratemaking are common across the U.S. Given the widespread adoption of decoupling (*see, e.g.*, NS-PGL Ex. RAF-3.0, at 5) in other jurisdictions, it is doubtful that the practice could be so widely employed if it violated those rules.

<sup>9</sup> The AG's request for "augmentation and modification" of the Proposed Order (AG BOE at 9-10) is little more than an attempt to obtain a sweeping ruling that Rider VBA violates all of the legal tenets that the AG and Staff have argued are applicable.

the Utilities have experienced persistent revenue shortfalls and that climate and usage conditions impair their ability to fully recover approved revenues under current ratemaking formulae. Those same factors could also cause customers to pay more than the approved revenue level. *See, e.g.*, PGL Ex. RAF-1.0, at 8; NS Ex. RAF-1.0, at 7; NS-PGL Ex. RF-2.0, at 45. *See also* PGL Exs. LTB-1.2 and LTB-1.3. The technical arguments about whether other measures of the Utilities' business have any bearing upon margin revenues or whether O&M productivity gains have any relevance are beside the point. The unchallenged evidence of record is that, due to warming weather and customer conservation efforts, margin revenues and usage per customer have been and continue to be in decline and that the traditional assumptions of stability no longer exist.

Neither Staff nor the AG has submitted evidence that rebuts the Utilities' proof that they have been increasingly unable to fully recover margin revenues since 2003. Rather, Staff and the AG point to the Utilities' return on equity as though it equates to margin revenues, when there is no question that they are not the same thing. Staff and the AG have not suggested that there are alternative ratemaking mechanisms other than the proposed riders that would address the business challenges that the Utilities have demonstrated. Thus, not only have the Utilities met their burden of proof by sufficiently demonstrating their inability to reasonably recover margin revenues in today's environment, Staff and the AG have utterly failed to offer any actual evidence to the contrary.

Rather, the AG and Staff continue to cling to hidebound positions that the Commission's "traditional" ratemaking determinations must not in any way be adjusted to address changing conditions that the Utilities have amply demonstrated. Irrespective of the evidence to the contrary, those parties continue to parrot that the Utilities' business is essentially the same as it

has been and that no new challenges are present that warrant taking a fresh look or reevaluating existing ratemaking practices. These parties maintain this “bury your head in the sand” position notwithstanding the widespread and dramatic direction to the contrary that is being pursued elsewhere.<sup>10</sup> Decoupling is the subject of intense analysis and discussion in utility literature, industry debate, as well as, formal proceedings involving many utilities. It is unrealistic to expect that the topic would not be raised in Illinois and that it would not require thoughtful consideration by this Commission in a utility proceeding. The Utilities have presented the issue squarely to the Commission, and it merits full and fair consideration, not superficial and summary rejection simply because it involves change. It is the Commission’s responsibility to thoughtfully and fairly evaluate utility rate proposals, including Rider VBA, with a view toward arriving at a just and reasonable decision based on the specific record evidence presented as well as the most cogent policy considerations.

The Utilities have presented the Commission with an alternative rate design mechanism that would partially address the effects of the changing environment on the utility’s ability to remain financially stable. That mechanism, Rider WNA, which is similar to mechanisms adopted in at least half the States, is an indication of the extent to which the Utilities have sought to offer a range of balanced and reasonable approaches to the changed business and climate environments of today. Outright rejection of Rider WNA, for the same reasons as discussed in respect of Rider VBA, is unreasonable. Rider WNA should be fairly evaluated and addressed as an alternative to decoupling.

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<sup>10</sup> There may not be unanimity as to exactly how many state commissions or on how many utilities decoupling has been considered and approved and under what conditions. It is inarguable, however, that decoupling is an issue of the day receiving widespread and serious consideration, and it should not simply be dismissed out of hand as suggested by its opponents in this proceeding.

### C. Rider ICR

The AG and Staff did not raise any new arguments or address matters with respect to Rider ICR that have not already been discussed in the opening briefs and the NS-PGL BOE. As was discussed in connection with Rider VBA and Rider WNA, Staff and the AG simply present what appear to be knee jerk arguments opposing Rider ICR on the grounds that Rider ICR violates certain legal criteria. These arguments of Staff and the AG are not well founded for reasons that have been detailed in the opening briefs and the NS-PGL BOE. Staff and the AG largely ignore the arguments that Peoples Gas and the City have made concerning the salutary effect of accelerated main replacement on the City of Chicago. They offer no response to the cogent public policy issues that are raised by the potential modernization of the City of Chicago's gas utility infrastructure. As with Rider VBA, the Commission should view the positions of Staff and the AG skeptically. Those positions amount to little more than inflexible attempts to quell all new Riders (other than Rider EEP, as to the AG) regardless of whether this would impede worthwhile improvements, rather than attempts to promote reasonable policy.

The City of Chicago, however, excepted to the Proposed Order on the grounds that there are important policy considerations that warrant approving Rider ICR. The City of Chicago focused on the enhanced safety which ensues from the replacement of cast iron and ductile iron ("CI/DI") main. The City of Chicago aptly points out that Peoples Gas has never asserted that the replacement of CI/DI main is necessary to address safety and reliability issues. Accelerating this replacement, of course, would enhance the safety and reliability of the system based on its complete modernization.

No party could argue that there is not a need to replace old CI/DI mains and that the complete replacement of those facilities will result in the most modern and reliable gas infrastructure for the City of Chicago. Furthermore, the replacement of CI/DI main will result in

the reduction of leaks and other disruptions that are problematic for Peoples Gas, its customers and the City of Chicago. Doerk Dir., PGL Ex. ED-1.0, at 17-19. Maximizing the safety and reliability of the system is an ongoing goal of Peoples Gas, and the complete replacement of CI/DI main is an important element in achieving the maximum practicably attainable safety and reliability. Rider ICR and replacement of old CI/DI main would provide the City and ratepayers with an effective tool to advance Peoples Gas' goal.

Peoples Gas believes that accelerating main replacement under Rider ICR will improve the overall quality of natural gas service in the City of Chicago and will contribute to the betterment of the quality of life in the City. The replacement of CI/DI main will greatly improve the City of Chicago's natural gas distribution infrastructure. As Peoples Gas has pointed out earlier, the City of Chicago is unique in its age, density and the composition and age of its gas distribution mains. *See* NS-PGL Ex. JFS-3.2. This reality, along with the City of Chicago's strong desire for gas distribution infrastructure modernization, presents the Commission with the most compelling public policy reason to allow Peoples Gas to accelerate the CI/DI main replacement. Rider ICR is the most appropriate mechanism for doing so and should be approved by the Commission.

**D. Rider EEP**

**1. Merits of the Utilities' Proposed Energy Efficiency Program**

In a proposal with broad support among the parties, the Utilities have proposed \$7.5 million earmarked for energy efficiency programs. The Proposed Order (at 169-170) recommends that these measures be adopted.

In a recent major gas utility rate case the Commission stated:

The Commission understands the importance of energy efficiency, and has begun to address other aspects of the issue in the Sustainable Energy Plan. That

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

*In re Northern Illinois Gas Co.*, ICC Docket No. 04-0779, p. 192 (Order Sept. 20, 2005). In that case, the Commission declined to impose the energy efficiency measures on a utility that did not propose or support them. Subsequently, in its Order approving the reorganization of the Utilities into the Integrys family, the Commission approved a condition to the transaction requiring the Utilities to propose a \$7.5 million energy efficiency program in the Utilities' next rate cases. *In re WPS Resources, Inc.*, ICC Docket No. 06-0540, p. 24 (Order Feb. 27, 2007). The Utilities have satisfied that condition, and their proposed energy efficiency program enjoys the support of the AG, the City of Chicago, CUB, and ELPC.

Staff is the lone holdout. Staff in its Brief on Exceptions restates its arguments raised with and rejected by the ALJs. Staff complains that the Proposed Order does not set out with specificity the precise programs for which the earmarked funds will be used. Staff BOE at 73. That is not a valid objection. This rate case is not the appropriate venue for arguing over amounts of rebates or models of furnaces. What the Utilities have proposed is a structure designed to ensure that whatever programs are put in place, they will have broad support (and, of course, Staff has a seat at that table) and can be monitored and tested for effectiveness. NS-PGL Ex. IR-3.0, at 3. The Proposed Order sets the appropriate stage for successful programs to be developed and implemented.

Staff also contends that the measures approved in the Proposed Order are uneconomic, because while paid for by all ratepayers in two service classes, they will not equally benefit all

ratepayers in those classes. This argument proves too much, as a similar argument could be made as to virtually any taxpayer-funded program. If the structure is implemented as discussed in the Proposed Order, with the broad representation on the decision-making panels, it is clear that the programs implemented will affect a wide array of ratepayers. Staff's Exceptions should be denied.

## **2. Rider Treatment**

ELPC, the AG, and Staff take exception to the Proposed Order's conclusion (at 170-171) finding rider treatment preferable for EEP. ELPC and the AG suggest the Proposed Order stigmatizes the EEP and communicates that the Commission might be committed to energy efficiency in theory, but not in fact. They reason that this is so because the Proposed Order provided for Rider treatment. ELPC and the AG's argument are unpersuasive and not supported by the record.

The Proposed Order is crystal clear regarding the importance of the EEP and rider treatment for EEP costs in no way diminish the significance of energy efficiency programs. The Proposed Order is unequivocal that "the Commission is highly pleased to consider and accept the EEP..." Proposed Order at 169. Thus, the importance of energy efficiency programs is well emphasized and suggestions to the contrary are misplaced.

ELPC and the AG also suggest that the record of evidence does not support the Proposed Order's conclusion that the EEP expense amounts are sufficiently uncertain. The gist of their argument is that they believe that the Proposed Order's finding that the \$7.5 million EEP expense is sufficiently volatile to justify rider treatment appears to rest on the finding by the Proposed Order that, "spending levels are uncertain and have been acknowledged as such, by ELPC witness Kubert". AG BOE at 38, citing Proposed Order at 170; ELPC BOE at 4. Both

parties attribute that finding to the “disingenuous” characterization of Mr. Kubert’s testimony by Peoples Gas which allegedly takes witness Kubert’s testimony out of context. AG BOE at 38. They conclude, “[i]n no way, as the Companies assert, did Mr. Kubert suggest that the amount of ratepayer-supplied funds would fluctuate between the \$8.7 million and \$36.5 million extremes. Accordingly, the PO’s reliance on the Companies’ distortion of Mr. Kubert’s testimony as a basis for concluding that the proposed EEP expense in this case is ‘uncertain’ has no basis in fact.” AG BOE at 39. ELPC and the AG argument miss the point.

ELPC and the AG’s argument suggest that the Peoples Gas’ “disingenuous” interpretation has provided the only basis for the Proposed Order’s “deduction that rider recovery of the EEP expense is appropriate”. AG BOE at 38. Clearly, this is not the case.

The parties objecting to rider treatment have argued that because the Utilities have agreed to spend \$7.5 million, *i.e.*, a fixed amount, that the Utilities cannot utilize a rider to recover these expenses because since the amount is known, it cannot possibly be “unexpected, volatile or fluctuating”. We disagree. **The parties prominently rely on the *Finkl* case. Later decisions, however, have held that nothing in *Finkl* limits the use of a rider to only those instances where costs are unexpected, volatile or fluctuating.** *City of Chicago v. Illinois Commerce Commission*, 281 Ill. App.3d 617 (1<sup>st</sup> Dist. 1996). In any event, spending levels are uncertain and have been acknowledged as such, by ELPC witness Kubert. Annual costs during start-up period will be lower and the extra money will be spent in later years.

Proposed Order at 170 (emphasis added).

The Proposed Order is very clear that the basis for its finding is the Court’s decisions in *Finkl* and *City of Chicago* and not simply Mr. Kubert’s testimony. In fact, Mr. Kubert’s testimony appears to simply be an afterthought, or at most an additional basis supportive of its finding. Nonetheless, ELPC and the AG are still incorrect respecting Mr. Kubert’s testimony. In Mr. Kubert’s reply testimony discussing the EEP program, he states, “[a] greater amount is eventually needed to reach full potential of these programs. However, several years of program

experience may be required before a ramp-up to a high funding level.” ELPC Ex. Kubert 1.0, lines 120-122. As is clear from Mr. Kubert’s testimony, he certainly finds that EEP expense amounts are uncertain. ELPC and the AG arguments to the contrary are without merit.

ELPC and the AG take issue with the Proposed Order’s language suggesting that a rider would allow the Commission to terminate the EEP at any time instead of waiting for a rate case. ELPC and the AG suggest that approval of a rider indicates Commission support for the EEP is an “aside and tentative”. ELPC BOE at 2, AG BOE at 42. The arguments of ELPC are illogical and unpersuasive. A rider is nothing more than a suitable mechanism by which the Utilities will collect the EEP costs. A rider and its operation (whether terminable at a specific time or otherwise) reflects no negative value judgment as to the worthiness or anything else about the particular program costs being recovered. ELPC’s and the AG’s positions are more grounded in the unyielding and hidebound opposition to riders in general that is discussed above in connection with Rider VBA. The Proposed Order correctly finds that rider treatment is justified to limit the Utilities to recovery of only the costs of the EEP that they incur and ratepayers will benefit by only being charged the amount actually spent. Proposed Order at 170. The arguments asserted by ELPC and the AG are without merit and should be rejected.

ELPC also argues that singling out EEP for rider treatment as a line item on customer bills is inappropriate because it is an insignificant charge, and communicates that the EEP program should not be considered a part of a natural gas utility’s business or is it integral to natural gas delivery. These are fallacious arguments and should be summarily rejected. EEP costs are a new and significant category of costs that are being accorded rider treatment and like all rider surcharges should be separately stated on customer bills. ELPC is seeking to have the Commission adopt a Schedule of Rates that hides the EEP costs from customers, as if to pretend

that there are no costs associated with energy efficiency.<sup>11</sup> Such an inferior billing practice should not be countenanced by the Commission.

Finally, in the alternative, if the Commission were to adopt ELPC's or the AG's proposed Exceptions as to Rider EEP, the Commission should not adopt the language they propose that would incorrectly circumscribe the Commission's authority to adopt riders, and the Commission needs to add language clearly providing for recovery of all EEP costs in base rates. The AG's proposed language clearly provides for recovery through base rates, but ELPC's proposed language, while it appears to also provide for recovery through base rates, is not quite as clear.

## **VIII. COST OF SERVICE**

### **B. Embedded Cost of Service Study**

#### **2. Contested Issues**

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

The AG and City-CUB excepted to the Proposed Order's finding, at pages 194-195, that the Utilities' proposed bifurcation of Service Classification ("S.C.") No. 1 into heating (S.C. No. 1H) and non-heating (S.C. No. 1N) classifications is fair and reasonable. AG BOE at 44-46; City-CUB BOE at 45-49. The Proposed Order correctly evaluated the record and made appropriate findings. The Utilities provided cost support for splitting S.C. No. 1 into two service classifications and refuted GCI witness Glahn's arguments against the proposals. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 11; NS Ex. VG-1.0 3REV, at 9-10; NS-PGL Ex. VG-2.0, at 33-39, 41-43; NS-PGL Ex. VG-3.0 REV, at 12.

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<sup>11</sup> The Utilities have established that not only are the actual costs of EEP programs a consequence of energy efficiency, but also that there are other financial impacts that must be recognized in rates that can only be addressed by adopting decoupling.

The AG contends that the Utilities failed to show that the split is justified on the basis of cost causation and argues that it would result in unjustified higher rates for heating customers. The AG also argues that heating customers will subsidize non-heating customers. AG BOE at 45. City-CUB argue that the Utilities' cost of service does not support its proposal and contend that, coupled with the proposed customer charges, it would disproportionately and adversely affect low and fixed income customers. City-CUB BOE at 45-49.

The cost basis for the bifurcation is clear. For Peoples Gas, the embedded, fixed costs of serving a small residential heating customer (\$39.10) are more than double those costs for such a non-heating customer (\$19.03) as are the allocated, fixed costs (\$36.24 *versus* \$16.06). PGL Ex. VG-1.5, p. 1. For North Shore, the difference is also substantial (embedded fixed costs of \$29.96 *versus* \$17.23).<sup>12</sup> NS Ex. VG-1.4, at 1. The AG's and City-CUB's discussions (AG BOE at 45 and City-CUB BOE at 46-47) of the effect of shared service lines is incorrect. The shared service line, which is typical for Peoples Gas' non-heating customers (97%), is usually associated with a multi-unit building having a central heating plant and individually metered tenant accounts for non-heating uses. NS-PGL Ex. RJA-2.0, at 15. The implication that such a shared service line serves only two single family dwellings (City-CUB BOE at 46) is not supported in the record. The line could serve many customers, and the embedded cost of service study ("ECOSS") assigns each customer its share of costs based on, *inter alia*, the number of meters attached to the line. NS-PGL Ex. RJA-2.0, at 16.

Given the large cost difference between serving heating and non-heating customers, the bifurcation would allow customer charges at levels that recover a more appropriate portion, but

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<sup>12</sup> The cost data are for rates without proposed Rider UBA. The allocated cost data for Peoples Gas are based on application of the equal percentage of embedded cost ("EPEC") method recommended by the Proposed Order.

still significantly less than 100%, of fixed costs from each class. PGL Ex. VG-1.0 2REV, at 12, 14; NS Ex. VG-1.0 3REV, at 10-12. In Peoples Gas' last rate case, the Commission stated that Peoples Gas' customer charge "should be increased in future rate proceedings to move it closer to cost." *In re The Peoples Gas Light and Coke Company*, ICC Docket 95-0032, p. 106 (Order Nov. 8, 1995). The Utilities' proposals continue their gradual move to customer charges that recover fixed costs as determined by each of their ECOSS.

Claims that the Utilities' proposals disproportionately affect heating customers are incorrect. All parties' rate increase allocation proposals show a slightly higher percentage increase for non-heating customers compared with heating customers. NS-PGL Ex. VG-2.2. The percentages of total, embedded fixed costs recovered through the customer charges are also roughly comparable. For Peoples Gas' S.C. No. 1N, 62% of such costs would be recovered through the proposed customer charge, and for S.C. No. 1H, 52% of such costs would be so recovered. PGL Ex. VG-1.0 2REV, at 12, 14. For North Shore's S.C. No. 1N, 65% of such costs would be recovered through the proposed customer charge, and for S.C. No. 1H, 55% of such costs would be so recovered. NS Ex. VG-1.0 3REV, at 10-12.

Contentions that the bifurcation would adversely affect low and fixed income customers (City-CUB BOE at 47-49) are flawed. The claim that such customers are harmed more by higher customer charges than distribution charges has no support. Indeed, GCI witness Glahn contends that higher distribution charges can also adversely affect such customers. GCI Ex. 3.0 REV, at 19. While Mr. Glahn opposed the Utilities' proposed customer charges, he did not propose specific distribution charges (Glahn, Tr. at 1218-1219), design such charges or propose how to design such charges. He, therefore, presented no bill impact analyses and no evidence showing his proposals' effects on customers. The Utilities did such analyses. For a given

revenue requirement, if the customer charge is higher, then the distribution charge is lower and *vice versa*. NS-PGL Ex. VG-2.0, at 37; Glahn, Tr. at 1228. Consequently, Mr. Glahn’s proposal to reduce substantially the Utilities’ proposed customer charges means the distribution charges must increase. The Utilities showed that moving more recovery to the distribution charges, as would result from Mr. Glahn’s proposed customer charges, is detrimental to Peoples Gas’ low income customers because of their usage patterns. NS-PGL Ex. VG-2.0, at 37-39. For North Shore, the impact on low income customers is fairly small. *Id.*, at 42-43.

The Proposed Order’s analysis of allocation issues associated with S.C. No. 1, including the bifurcation of this service classification, is complete and accurate. The AG’s and City-CUB’s proposed exceptions should be rejected.

**e. Differentiated Class Rates of Return**

City-CUB proposed revisions to page 200 of the Proposed Order on the theory that the Utilities failed to meet their burden of proof regarding the allocation of the revenue requirement. City-CUB BOE at 51-52. The Utilities’ burden of proof does not require them to respond to unsupported conjecture. Having presented a *prima facie* case in support of their ECOSS and their allocations, the burden of going forward with the evidence shifted to Staff and intervenors. *Board of Trade of the City of Chicago v. Dow Jones & Company, Inc.*, 108 Ill. App. 3d 681, 686 (1st Dist. 1982) (“the burden of proof” has two aspects: (1) the burden of producing evidence as to a particular matter; and (2) the burden of persuading the trier of fact as to the existence of the fact asserted. The burden of producing evidence, which is sometimes called the burden of going forward, shifts from party to party during the course of the trial, but the burden of persuasion ... does not shift.”). The “ample reason” cited by City-CUB (City-CUB BOE at 51) in support of their argument is a witness’ statement that customers’ usage is affected by different factors and

“it makes sense” that each class contributes a different level of risk. City-CUB Ex. 1.0 at 77. These few lines of testimony and what a witness, without more, opines “makes sense” did not refute the Utilities’ *prima facie* showing and shift the burden of going forward to the Utilities. NS-PGL Ex. RJA-2.0, at 18-19.

The Proposed Order’s discussion of this issue, at pages 198-200, is complete and accurate, and City-CUB’s proposed exception should be rejected.

## **IX. RATE DESIGN**

### **B. General Rate Design**

#### **1. Allocation of Rate Increase**

The AG and City-CUB excepted to the Proposed Order’s adoption, at page 212, of Peoples Gas’ use of the equal percentage of embedded cost (“EPEC”) method for certain revenue requirement allocations. AG BOE at 46-50; City-CUB BOE at 53-57. The Proposed Order correctly evaluated the record and made appropriate findings. Peoples Gas supported using the EPEC method and refuted arguments made by the AG and City-CUB. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 6-8; NS-PGL Ex. VG-2.0, at 11-17; NS-PGL Ex. 3.0, at 6-7.

The AG and City-CUB each contends that the EPEC relied improperly on what the AG called “arbitrary” groupings (AG BOE at 48). Each also criticizes setting S.C. No. 4 at cost and allocating no costs to S.C. No. 7.

#### **EPEC Method**

In addition to precedent, which supports the Proposed Order’s findings, there are sound reasons for Peoples Gas to use the EPEC method. The AG’s and City-CUB’s arguments about “groupings” are wrong in several respects and repeat GCI witness Glahn’s errors on this issue. First, Peoples Gas witness Grace explained that the EPEC was applied to S.C. Nos. 1N, 1H and 2

in order to move the two small residential service classifications gradually to cost. PGL Ex. VG-1.0 2REV, at 11. Second, S.C. Nos. 3 and 4 were grouped, and proposed to be consolidated, because these two service classifications serve large volume customers with increasingly similar load factors. *Id.*, at 24. Notably, unlike S.C. No. 2, S.C. Nos. 3 and 4 were, and S.C. No. 4 would continue to be, fully unbundled. NS-PGL Ex. VG-2.0, at 16. This distinction highlights the flaw in the AG’s and City-CUB’s erroneous grouping of S.C. Nos. 2 and 4 on the grounds of “horizontal equity.” The principle of horizontal equity is to treat equals as equals<sup>13</sup>, but S.C. No. 2 is unlike S.C. No. 4 and should not be treated the same. *Id.*, at 11-12. Third, the AG and City-CUB incorrectly stated that S.C. Nos. 6, 7 and 8 were grouped. AG BOE at 48; City-CUB BOE at 55. The Utilities presented each of these service classifications separately in testimony and exhibits. NS-PGL Ex. VG-2.0, at 11.

City-CUB appear to question whether the EPEC is an objective allocation method. City-CUB BOE at 54. EPEC is a mechanical allocation, and it is objective. Peoples Gas proposes to set S.C. Nos. 4, 6 and 8 at cost and to allocate the remaining revenue requirement among S.C. Nos. 1N, 1H and 2 using the EPEC method. The EPEC method allocates the remaining revenue requirement in proportion to the embedded costs of service for the three service classifications and the resulting amounts are added to the revenue generated under currently applicable rates for the particular service classification to arrive at the revenue to be provided under proposed rates. PGL Ex. VG-1.0 2REV, at 6. There is no subjectivity in this process, and PGL Ex. VG-1.3 shows the straightforward mathematics underlying the calculations.

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<sup>13</sup> The AG and City-CUB agree with this definition of this principle. AG BOE at 47; City-CUB BOE at 55.

#### **Service Classification No. 4**

Peoples Gas showed why it is important and beneficial to all customers to set S.C. No. 4 at cost. These are large volume customers. Indeed, the service classification is only available to customers with average monthly usage of at least 41,000 therms. PGL Ex. VG-1.1, at 9. Setting this rate over cost could induce these customers to physically or economically bypass Peoples Gas' system. Since Peoples Gas' last rate case, the number of such large volume customers has declined significantly. Additional losses of such customers would reduce fixed cost recovery, and, given that Peoples Gas' costs are overwhelmingly fixed, it would result in higher rates for the remaining customers. NS-PGL Ex. VG-2.0, at 16, 24.

The AG repeats GCI witness Glahn's misstatement that S.C. No. 4 rates would be less than its allocated cost. AG BOE at 47. Peoples Gas proposed to combine current S.C. Nos. 3 and 4 into a single service classification to be called S.C. No. 4. Peoples Gas proposed to set S.C. No. 4 at cost. The AG's error is apparently based on exhibits that show current S.C. No. 3 at 100.9% of cost and current S.C. No. 4 at 98% of cost. Combined, the proposed S.C. No. 4 is at cost. NS-PGL Ex. VG-2.0, at 15-16.

Also, the Proposed Order's recommended use of the average and peak ("A&P") allocator for distribution system investment would increase S.C. No. 4's total revenue requirement as well as the demand related revenue requirement.<sup>14</sup> If the Commission adopts the A&P allocator, then the higher cost basis makes it more important that S.C. No. 4 continue to be set at cost. The Commission should also be sensitive to the impact of the A&P allocator's cost shifts. If the Commission adopts the A&P allocator, then the total revenue requirement as well as the demand

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<sup>14</sup> The Utilities excepted to the Proposed Order's conclusions about the proper allocator for distribution system investment. For the reasons stated on pages 71-75 of their BOE, the coincident peak allocator should be adopted. Also see Exception No. 21, NS-PGL Exceptions at 53-54.

related revenue requirement for S.C. No. 4 would be much greater than if a Coincident Peak allocator is adopted. As the record shows, the revenue requirement for S.C. Nos. 3 and 4 would be \$15.9 million (\$10.0 million for S.C. No. 3 and \$5.9 million for S.C. No. 4) assuming an A&P allocator, of which \$13.6 million (\$8.4 million for S.C. No. 3 and \$5.2 million for S.C. No. 4) would be demand related. *See* Staff Ex. 19.0, Sch. 19.2-PG. This compares with a \$13.1 million revenue requirement (\$8.5 million for S.C. No. 3 and \$4.6 million for S.C. No. 4), of which \$10.8 million (\$7.0 million for S.C. No. 3 and \$3.8 million for S.C. No. 4) would be demand related, under Peoples Gas' proposal. *See* PGL Ex. RJA-1.7, p. 3 of 4.

As indicated in the preceding paragraph, Peoples Gas' proposed rate design resulted in each service classification being quite close to cost and the combined classification at cost. Changes to cost allocations could affect one service classification's customers more than the other's. Peoples Gas explained the importance of properly setting customer and distribution charges to mitigate the impact on the former S.C. No. 3 customers. NS-PGL Ex. VG-2.0, at 45-46. Accordingly, the final rate design should set each former service classification close to cost, and the combined service classification at cost to mitigate the impact on customers.

#### **Service Classification No. 7**

The Proposed Order at pages 246-247 correctly concluded why Peoples Gas' treatment of S.C. No. 7 in its ECOSS was appropriate. Specifically, Peoples Gas excluded S.C. No. 7 because it is a negotiated rate service available to customers who are able to bypass Peoples Gas' system. PGL Ex. VG-1.0 2REV, at 8. Revenues from this service classification offset fixed costs and mitigate the rate increase to other customers. NS-PGL Ex. VG-2.0, at 17.

The Proposed Order properly concluded that Peoples Gas' allocation of the rate increase, including its use of the EPEC method for S.C. Nos. 1N, 1H and 2, setting S.C. No. 4 at cost and

crediting S.C. No. 7 revenues in the ECOSS, is reasonable. The AG's and City-CUB's exceptions to this section of the Proposed Order should be rejected.

**2. Gas Cost Related Uncollectible Expense**

The AG and City-CUB excepted to the Proposed Order's adoption, at page 217, of Staff's proposed method, with the Utilities' proposed corrections, for recovering gas cost-related uncollectible expenses from sales and transportation customers. The AG generally repeats the arguments that appeared in its reply brief and to which the Proposed Order, at page 217, invited comments. AG BOE at 50-52. City-CUB supported the AG's position and provided no record support for an alternative approach. City-CUB BOE at 58-59. The Utilities addressed these arguments on pages 80-82 of their BOE and proposed language for inclusion in the Proposed Order as their Exception No. 24 (NS-PGL Exceptions at 56-57).

The AG's and City-CUB's exceptions should be rejected, and the Utilities' Exception No. 24 should be adopted for the reasons set forth in the Utilities' BOE.

**C. Service Classification Rate Design**

**2. Contested Issues**

- a. Peoples Gas Service Classification Nos. 1N and 1H**
- b. North Shore Service Classification Nos. 1N and 1H**

The AG, City-CUB, and Staff excepted to the Proposed Order's adoption, on pages 238-239, of the Utilities' S.C. Nos. 1N and 1H proposals. AG BOE at 52-57; City-CUB BOE at 60-64; Staff BOE at 82-83. The Utilities supported their proposed rate design and addressed the Staff and intervenor arguments. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 11-22; NS Ex. VG-1.0 3REV, at 9-19; NS-PGL Ex. VG-2.0, at 25-43; NS-PGL Ex. VG-3.0 REV, at 7-12.

### **The AG**

The AG narrowly focused on the proposed customer charges and its complaints about the bifurcation of S.C. No. 1 into heating and non-heating classifications. These arguments are addressed in connection with the bifurcation section of the Proposed Order (*see* Section VIII.B.2.c, *supra*). As explained above, the proposed customer charges gradually and appropriately move those charges toward greater recovery of fixed costs through the fixed customer charges and do not unfairly affect low and fixed income customers. Mr. Glahn's recommendations are not based on the Utilities' ECOSS or any cost of service study. Mr. Glahn did not prepare a cost of service study. Glahn, Tr. at 1221. The AG explains that Mr. Glahn compared his recommended customer charges with those of other Illinois gas utilities and used a "common-sense approach." AG BOE at 56. Presumably, the other utilities' rates that he referenced were developed based on those utilities' cost studies and rate design principles. NS-PGL Ex. VG-2.0, at 35. The record does not include any explanation for why these other utilities' charges would be appropriate, cost-based charges for Peoples Gas and North Shore. Mr. Glahn simply described his Peoples Gas proposal as placing Peoples Gas "squarely in the middle." GCI Ex. 3.0 REV, at 34. The Proposed Order correctly found that Mr. Glahn's proposals lacked solid analytical underpinnings and reasonably rejected them.

### **City-CUB**

City-CUB contend that the Utilities' proposed customer charges are inconsistent with rate design goals such as social goals and stability. City-CUB also characterize the Utilities' proposals as resulting in "rate shock." City-CUB BOE at 60, 64. As with the AG's arguments, City-CUB's arguments are addressed in connection with the bifurcation section of the Proposed Order (*see* Section VIII.B.2.c, *supra*).

City-CUB also argue that the Proposed Order disregards the statutory burden of proof. As with Section VIII.B.2.e, *supra*, City-CUB's burden of proof arguments are flawed. The Utilities proffered substantial evidence in support of their S.C. Nos. 1N and 1H proposals. That evidence took the form of an ECOSS for each company, proposals for all rate components of all service classifications (*e.g.*, both customer and distribution charges for S.C. Nos. 1N and 1H) and methods for deriving distribution charges if the Commission orders revenue requirements that differ from the Utilities' proposals. Only the Utilities proposed specific methods for easily and objectively determining distribution charges, whatever revenue requirement the Commission approves. *See, e.g.*, NS-PGL Ex. VG-3.0 REV, at 5-6, 18, 19, 22-23.

Moreover, the Utilities' proposals are consistent with many of the goals, including social goals, articulated by Mr. Glahn and the sources he cites (AGA and Dr. Bonbright). NS-PGL Ex. VG-2.0, at 6-7. For example, as addressed in Section VIII.B.2.c, *supra*, the increased customer charges, when coupled with the necessarily lower distribution charges, do not adversely or disproportionately affect low or fixed income customers. The Utilities supported their conclusions with data drawn from their service territories (NS-PGL Ex. VG-2.0, at 37-39), in contrast with Mr. Glahn who drew general conclusions from census surveys for the Chicago area (GCI Ex. 6.1). Peoples Gas' use of the EPEC method mitigates the impact of its rate increase on small residential customers. Bifurcating S.C. No. 1 mitigates the impact of higher customer charges on S.C. No. 1N. Proposed Rider EEP will make available conservation programs to all S.C. Nos. 1H and 2 customers, with funds specifically targeted to low income customers. NS-PGL Ex. VG-2.0, at 8. The Utilities' proposals take many rate design principles, including social goals, into account.

The AG incorrectly characterized the Utilities’ proposed customer charges as “akin to the goal of revenue decoupling.” AG BOE at 54. The Utilities’ proposed customer charges fall far short of recovering all fixed costs through fixed charges, and, thus, far short of revenue decoupling. As Ms. Grace explained, over 90% of the Utilities’ costs are fixed. Under the Utilities’ proposals, without proposed Rider UBA, Peoples Gas would recover 45% of its costs through fixed charges<sup>15</sup> and North Shore would recover 50% of its costs through fixed charges<sup>16</sup>. A proposal akin to revenue decoupling would be straight fixed variable (“SFV”) rate design, which recovers all fixed costs through fixed charges. Utilities witness Grace presented such rates for consideration in these proceedings, but, in the interest of gradualism, the Utilities did not propose their adoption. PGL Ex. VG-1.0 2REV, at 16-18; NS Ex. VG-1.0 3REV, at 14-16.

Finally, City-CUB contend that, if the Commission rejects Mr. Glahn’s proposals, it should require the Utilities to adjust their charges (City-CUB BOE at 63) or reject the Utilities’ proposals if it approves a revenue requirement lower than the Utilities’ request (City-CUB BOE at 64). First, the record shows that the Utilities’ proposed charges are far below fixed costs. There is no evidence that reduced revenue requirements would cause the proposed charges to exceed the fixed costs. Second, the proposal is unclear. If City-CUB is proposing that approval of any revenue requirement lower than the Utilities’ request should result in no change to the existing customer charges, there is no record support for such a proposal. Even Mr. Glahn proposed slight increases to the charges. Third, if City-CUB is proposing that the Commission order other charges, City-CUB provides no guidance for how the Commission should set such

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<sup>15</sup> Under present rates, this figure is only 30%. Under Mr. Glahn’s proposals, it would drop to 28%. NS-PGL Ex. VG-2.0, at 23.

<sup>16</sup> Under present rates, this figure is only 31%. Under Mr. Glahn’s proposals, it would drop to 28%. NS-PGL Ex. VG-2.0, at 23.

charges and points to nothing in the record upon which the Commission can rely. City-CUB's alternative proposal must be rejected.

As Mr. Glahn agrees, no rate design can meet all the sometimes conflicting rate design objectives identified by AGA and Dr. Bonbright. GCI Ex. 3.0 REV, at 7, 9; Glahn, Tr. at 1217. The Utilities met their burden to design cost-based rates that resolve these conflicting objectives in a reasonable manner.

### **Staff**

Staff excepts to the Proposed Order's adoption, on pages 238-239, of the Utilities' bifurcation proposal. The Staff disagrees with the Proposed Order's conclusions regarding Staff's proposal for effectuating the bifurcation of S.C. No. 1, and it proposes that the Commission reject the bifurcation of S.C. No. 1. Staff also argues that the bifurcation would be detrimental to non-heating customers with high use. Staff BOE at 82-83. The Utilities demonstrated the problems with Staff's bifurcation proposals, and the Proposed Order correctly recognized that those proposals were insufficiently detailed for adoption. *See, e.g.*, NS-PGL Ex. VG-2.0, at 26-32; NS-PGL Ex. VG-3.0 REV, at 7-10.

The Utilities' proposal to use heating and non-heating designations as the basis for splitting S.C. No. 1 is reasonable. The Utilities routinely keep this information, and their bill frequency data show that the heating/non-heating split makes sense from a rate design perspective. NS-PGL Ex. VG-2.0, at 31-32. With respect to the impact on non-heating customers with high use, note that the Staff's example in its BOE is for monthly usage of 70 therms. About 97% of Peoples Gas' non-heating S.C. No. 1 bills are for 50 therms or less (PGL Ex. VG-1.0 2REV, at 13) and the comparable figure for North Shore is 91% (NS Ex. VG-1.0

3REV, at 11). Staff's example applies to a tiny fraction of the monthly bills of non-heating customer class.

However, if the Commission accepts the Staff's proposal to reject bifurcation of S.C. No. 1, the Utilities' proposal for S.C. No. 1 should be adopted. The Staff's proposed revisions to the Proposed Order inaccurately describe the Utilities' proposal. Staff BOE at 84. First, the statement that the monthly customer charge for North Shore should be \$15.79 or less and the Peoples Gas monthly customer charge should be \$14.69 or less is incorrect. The companies are reversed. NS-PGL Ex. VG-3.1 shows, with Rider UBA, a charge for Peoples Gas of \$15.79 and for North Shore a charge of \$14.69. Second, although Staff does not support Rider UBA and the Proposed Order did not recommend adoption of Rider UBA, the Staff's BOE uses the lower charges that would result from adoption of Rider UBA. As NS-PGL Ex. VG-3.1 shows, the correct monthly customer charges, assuming the Utilities' proposed revenue requirements and no Rider UBA, would be \$16.90 for Peoples Gas and \$15.04 for North Shore. NS-PGL Ex. VG-3.0, at 11-12; NS-PGL Ex. VG-3.1.

In general, the Utilities' proposal if S.C. No. 1 is not bifurcated is that each utility's customer charge should reflect movement towards greater recovery of fixed costs through the customer charge. The Utilities proposed setting the customer charge at 50% of the revenue requirement for S.C. No. 1 and illustrated those charges based on their proposed revenue requirements. NS-PGL VG-3.0 REV, at 11-12; NS-PGL Ex. VG-3.1. *See* Alternative A below for proposed revisions to the Proposed Order, pages 194-195 and 238-239, to adopt this rate structure. Alternative A includes, as appropriate, the Utilities' proposed modifications to pages 238-239, set forth in Exception No. 25 of the NS-PGL Exceptions and would be in place of the language proposed in Exception No. 25 (NS-PGL Exceptions at 58).

## **ALTERNATIVE A**

The Commission Analysis and Conclusion on pages 194-195 (Section VIII.B.2.c) and on pages 238-239 (Section IX.B.2.a and b) of the Proposed Order should be revised as follows if the Commission rejects the Utilities' proposed bifurcation of S.C. No. 1:

### **VIII.B.2 (c) (6) Commission Analysis and Conclusion**

The issue at hand is whether S.C. No. 1 should be bifurcated into heating and non-heating customers. While the Utilities urge bifurcation, the GCI parties oppose it, and Staff appears to have an implementation issue. This situation requires the Commission to apply its best and considered judgment on the evidence and arguments presented.

The Commission is not persuaded by the opposition or the recommendations of GCI witness Glahn. Notably, he acknowledges that the heating and non-heating distinction is "common in the industry." Yet, he would dismiss the bifurcation proposal here on little more than his belief that the cost differentials between S.C. No. 1H and S.C. No. 1N are too high. We consider the Utilities to have effectively challenged Mr. Glahn's analysis and shown to the Commission that it has no bearing on whether the Utilities proposed bifurcation is appropriate, and further that his suggestion of a multi-family and single family bifurcation is unsupported. We further note that Mr. Glahn's average per customer calculations for service plant ignore the occurrence of multiple S.C. No. 1N customers served by shared gas service lines, while the Utilities' ECOSS properly account for the sharing of service lines by multiple customers.

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

Mr. Glahn's criticism that the 1N/1H bifurcation disproportionately impacts low income customers is unconvincing. We see evidence from the Utilities to show that their bifurcation proposal will actually result in lower rates, especially in the winter. This we cannot disregard. Finally, we observe that both the Utilities and Mr. Glahn agree that a subsidy from heating to non-heating exists. While Mr. Glahn appears to complain that there is lack of significant change in nominal percentages before and after the proposed bifurcation, we are not convinced that that this ground is

sufficient enough to reject the Utilities' S.C. No. 1 bifurcation proposal given all of the other justifications for the proposal on record.

However, while the Commission is not persuaded that bifurcation is not appropriate because of the implementation issues that the Staff raised, it is concerned about the possible rate impacts identified by the Staff. In particular, there could be a small number of non-heating customers who have relatively high usage in some months who would pay more than a heating customer with the same usage. The Commission, based on the record in these cases, is concerned about that result. Accordingly, on the entirety of the record and arguments, the Commission rejects the Utilities' proposed bifurcation.

~~The Commission is also persuaded that the bifurcation-related concerns raised by Staff, as well as the proposals Mr. Luth offered, need be rejected at this juncture. In any event, Staff did not adequately respond to the issues raised by the Utilities regarding his proposals and concerns.~~

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

#### **IX.B.2 (a)/(b) (6) Commission Analysis and Conclusion**

The issue is whether to implement a bifurcation between S.C. Nos. 1N and 1H as the Utilities have here proposed. Having reviewed the evidence, the Commission concludes that bifurcation of S.C. No. 1 into two service classifications would be reasonable, but it has concerns about the Utilities' and the Staff's proposals. ~~considers the Utilities' proposal to be both reasonable and based upon a method that is appropriate and supported by the record. 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, 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. However, Mr. Luth raised valid concerns about the impact of the Utilities' proposal on those non-heating customers who may have relatively high usage in a given month. While there appear to be a small number of customers falling into this category, the Commission agrees with Mr. Luth that they should not pay a higher rate than if they were on S.C. No. 1H. Accordingly, the Commission does not adopt the Utilities' proposed bifurcation. In its place, the Utilities proposed a rate design to retain a single service classification for small residential customers, and the Commission finds that proposal, including the method for setting the customer and distribution charges, to be a reasonable alternative to bifurcation of S.C. No. 1.~~

The Commission also believes that the embedded cost of service study is the most appropriate means of assigning costs to S.C. Nos. 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~~ proposed alternative to bifurcation represents the most reasoned approach to establishing just and reasonable rates for small residential heating and non-heating customers. Specifically, the Commission rejects proposals to bifurcate S.C. No. 1 and adopts: the Utilities' alternative proposal to retain a single service classification for small residential customers; the Utilities' proposed customer charges to be set at 50% of the revenue requirement for S.C. No. 1; the Utilities' proposals for calculating the distribution rates,

including a declining two block rate; Peoples Gas' use of the EPEC method; and setting North Shore's S.C. No. 1 at cost.

- c. **Peoples Gas Service Classification No. 2**
- d. **North Shore Service Classification No. 2**

The AG and City-CUB excepted to the Proposed Order's adoption, at page 242, of the Utilities' S.C. No. 2 rate designs. AG BOE at 57-58; City-CUB BOE at 65-66. The Utilities supported their S.C. No. 2 rate designs and refuted GCI witness Glahn's criticisms. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 22-24; NS Ex. VG-1.0 3REV, at 19-21; NS-PGL Ex. VG-2.0, at 43-45; NS-PGL Ex. VG-3.0 REV, at 22-24.

The AG argues that, in the interest of gradualism, the increase in the S.C. No. 2 customer charges should be less than the Utilities' proposal and that the proposed increase to the meter class 2 charge would represent "rate shock." AG BOE at 57-58. City-CUB made similar arguments about the customer charge and also argued that, if the Commission rejects Mr. Glahn's proposals, it should require the Utilities to submit "adjusted" charges to meet the approved revenue requirements. City-CUB BOE at 65-66.

The Utilities' proposed S.C. No. 2 customer charges properly reflect the gradual movement to fixed cost recovery through fixed charges. Over 90% of Peoples Gas' S.C. No. 2 costs are fixed. Even with the proposed increases, Peoples Gas would recover only 25% of the allocated revenue requirement through the fixed monthly customer charges. PGL Ex. VG-1.0 2REV, at 24. For North Shore, about 98% of the S.C. No. 2 costs are fixed. Even with the proposed increases, North Shore would recover only 34% of the allocated revenue requirement through the fixed monthly customer charges. NS Ex. VG-1.0 3REV, at 20. In other words, a substantial portion of fixed costs would remain to be recovered through the other charges.

As with his S.C. No. 1 proposals, GCI witness Glahn's S.C. No. 2 customer charge proposals are not based on a cost of service analysis, and he fails to provide any rate design proposals for the distribution charges. NS-PGL Ex. VG-2.0, at 44-45; Glahn, Tr. at 1218-1219, 1221. Indeed, the AG BOE does not even pretend that the proposals are based on a rigorous cost of service study and analysis and, instead, recites the percentage increases associated with the Utilities' proposals. AG BOE at 56. Mr. Glahn proposed a meter class 1 customer charge for Peoples Gas' S.C. No. 2 that would "match" a charge for another Illinois utility and "fall in the midst" of other utilities, stating that it "appears appropriate." GCI Ex. 3.0 REV, at 34. As with his S.C. No. 1 proposals, he does not explain why these comparisons with other utilities represent an appropriate cost basis for the Utilities' rates. Moreover, while the City-CUB BOE focuses on meter class 2 (City-CUB BOE at 66), Mr. Glahn's approach to meter class 2 did not include a comparison with other utilities' customer charges, some of which are higher than the Utilities' proposals. NS-PGL Ex. VG-2.0, at 44.

Regarding City-CUB's assertion that the Commission should require the Utilities to adjust their customer charges if the Commission approves lower revenue requirements than those requested by the Utilities, the proposal, like a comparable proposal for S.C. No. 1, is unclear. City-CUB provides no guidance for how the Commission should set such charges and points to nothing in the record upon which the Commission can rely. Additionally, the record shows that the Utilities' proposed charges are far below fixed costs. There is no evidence that reduced revenue requirements would cause the proposed charges to exceed the fixed costs. City-CUB's alternative proposal must be rejected.

However, the AG and City-CUB are correct that the Proposed Order should be revised regarding Mr. Glahn's testimony. The Utilities propose the following changes to page 242 of the Proposed Order:

IX.B.2 (c)/(d) (4)      **Commission Analysis and Conclusion**

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~~ limit the increase to the S.C. No. 2 customer charges to such a degree that they would remain far below the fixed costs for this service classification in a general rate increase framework. Mr. Luth's proposal to change the S.C. No. 2 demand device and administrative charges 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.

f.      **Peoples Gas Service Classification No. 4**

The AG and City-CUB excepted to the Proposed Order's adoption, at page 245, of Peoples Gas' S.C. No. 4 rate design. AG BOE at 58-59; City-CUB BOE at 67-68. Peoples Gas supported its S.C. No. 4 rate design and refuted GCI witness Glahn's criticisms. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 24-26; NS-PGL Ex. VG-2.0, at 13-16, 45-46; NS-PGL Ex. VG-3.0 REV, at 6-7, 24-26.

Peoples Gas' proposal to continue to set S.C. No. 4 at cost and its refutation of Mr. Glahn's allocations that would place that rate above cost are addressed in Section IX.B.1, *supra*. In addition, in trying to treat S.C. No. 4 as comparable to S.C. No. 2, the AG's BOE repeats Mr. Glahn's incorrect grouping of S.C. No. 2 with S.C. No. 4 and his inaccurate claim that S.C. No. 2 includes at least one customer that has the ability to bypass Peoples Gas' system. AG BOE at 59. Utilities witness Grace explained that the former S.C. No. 7 customer who moved to S.C. No. 2 has a much smaller load than when it received service under an anti-bypass

contract and that customer no longer has the economic and practical ability to bypass Peoples Gas' system. NS-PGL Ex. VG-3.0 REV, at 6-7. As with other service classifications, Mr. Glahn did not propose a specific rate design for S.C. No. 4. Rather, as is evident from the AG's and City-CUB's proposed changes to the Proposed Order, his recommendations were limited to an allocation of the revenue requirement and do not include any specific proposals for the various S.C. No. 4 charges, which include customer, two-block demand, standby service and distribution charges. PGL Ex. VG-1.0 2REV, at 25. The Proposed Order properly rejected Mr. Glahn's incomplete proposals, and the AG and City-CUB exceptions should be rejected.

**g. Peoples Gas Service Classification No. 7**

The AG and City-CUB excepted to the Proposed Order's adoption, at page 246-247, of Peoples Gas' treatment of S.C. No. 7 in its ECOSS. AG BOE at 60-61; City-CUB BOE at 68-69. Peoples Gas supported its S.C. No. 7 proposal and refuted GCI witness Glahn's criticisms. *See, e.g.*, PGL Ex. VG-1.0 2REV, at 8; NS-PGL Ex. VG-2.0, at 17. Peoples Gas' treatment of S.C. No. 7 in its ECOSS and its refutation of Mr. Glahn's proposal are addressed in Section IX.B.1, *supra*. S.C. No. 7 is available to customers who can bypass Peoples Gas' distribution system. These customers receive service under negotiated contracts based on proper cost considerations. The ECOSS includes a revenue credit of \$2 million reflecting Peoples Gas' S.C. No. 7 test year revenues. NS-PGL Ex. VG-2.0, at 17. S.C. No. 7 revenues are properly included as a credit in the ECOSS for the benefit of all customers. Proposals to also allocate costs to this service classification should be rejected.

**D. Tariff - Other Tariff Issues**

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

City-CUB excepted to the Proposed Order's adoption, at pages 249-250, of the Utilities' proposal to increase the charge for dishonored checks and incomplete electronic withdrawals from \$10 to \$25. City-CUB BOE at 70-71. City-CUB is correct that the charge is not entirely cost-based. The Utilities proposed to increase the charge to better reflect prevailing rates for dishonored checks and to discourage customers from making deficient payments. Revenues from the charge offset the base rate increase. PGL Ex. VG-1.0 2REV, at 32; NS Ex. VG-1.0 3REV, at 28-29. Staff witness Ms. Harden agreed with the proposed charge, quoting from a 2000 Commission order that the "increase was reasonable and would serve to discourage payments with checks that are not valid ... ." *In re MidAmerican Energy Company*, ICC Docket No. 99-0534, p. 40 (Order July 11, 2000). Staff Ex. 9.0, at 11. The Utilities' proposed charge should be approved. If it is reduced, then the amount of the credit offsetting base rates must also be reduced. NS-PGL Ex. VG-2.0, at 52-53.

**X. TRANSPORTATION ISSUES**

**C. Large Volume Transportation Program**

**4. Injection, Withdrawal and Cycling Requirements**

The Proposed Order rejected the Utilities' proposals to require transportation customers to reduce their gas in storage to specific levels at the end of the winter period (*i.e.*, at March 31). However, the Proposed Order approved the Utilities' proposals to require transportation customers to fill their AB up to at least 70% of their AB on the Peoples Gas system and up to at least 85% of their AB on the North Shore system on November 30 of each year. The Utilities gracefully accept their loss in their efforts to have transportation customers share in the storage

withdrawal requirements that the Utilities must meet in connection with their operation of their own storage assets (whether owned or leased). However, IIEC is unwilling to gracefully accept its corresponding loss on the issue of the Utilities' November 30 storage inventory requirements for transportation customers. Multiut similarly continues to object to the imposition of any November 30 storage inventory requirements. The Utilities believe that the Proposed Order represents a fair and reasonable balance of the interests of all the parties that framed the issues concerning storage shaping. The urgings of Multiut and IIEC would disturb the interest balance achieved by the Proposed Order and should be rejected.

The Proposed Order correctly found that the Utilities' operational needs during the heating season justify their adoption of fall injection targets for transportation customers. IIEC argues that the Utilities have been able to meet their own fall injection targets without imposing such requirements on individual transportation customers. However, that argument ignores the unrebutted evidence in the record that the absence of a fall injection target for transportation customers makes it more difficult for the Utilities to meet the fall injection requirements with which they must comply, and that it is inequitable that the burden of meeting these requirements falls solely on their bundled sales customers. NS-PGL Ex. TZ-2.0 at 32-33. IIEC also baldly asserts in footnote 3 of its BOE that "on its face, cycling requirements that can only be met by a utility on an aggregate basis are unjust and unreasonable when imposed on each individual customer." However, IIEC cites to no legal or record support for this assertion, which the Utilities certainly reject. Moreover, IIEC ignores the Proposed Order's acceptance, to which the Utilities did not except, of super pooling in connection with meeting this requirement.

Multiut opposes the adoption of fall injection targets by claiming that "the tariffs imposed under Rider FST already account for any costs associated with storage." Multiut BOE at 2.

Multiut's claim is wrong. Storage *capacity* charges are reflected in the charges imposed under Rider FST, but storage *inventory* charges are not. That is precisely why each Utility has proposed a fall storage inventory requirement for transportation customers. Multiut also claims that "Nicor's Rider 25 . . . is equivalent to [the Utilities'] Rider FST" and that Nicor's Rider 25 does not automatically include a storage banking service charge. This is a brand new argument on Multiut's part, and Multiut cites to no evidence in the record in support of it. The Utilities have not had the opportunity to examine Nicor's tariff or the rate design underlying the tariff on this issue, or to cross-examine Multiut's witnesses concerning the accuracy of this claim. This claim is untimely, and should be rejected summarily.

As noted in CNE-Gas's BOE, and as the Utilities expect Vanguard to note in its Reply BOE, the Utilities, CNE-Gas and Vanguard have concluded a settlement among them concerning most of the issues in these proceedings. As a part of that settlement, North Shore has agreed to reduce the fall injection target on its system from 85% to 75% of a customer's AB. Also as a part of that settlement, CNE-Gas, Vanguard and the Utilities have agreed to support the modification of the Proposed Order's year-round MDQ limits for Riders FST and SST with a Maximum Daily Nomination (MDN) limit during April through October. The MDN would be defined as the maximum amount of gas that a customer may deliver on any day. The MDN would be the customer's average daily use in the comparable month in the prior year plus 0.67% (20% of AB divided by 30). However, if a customer's usage profile materially changes as compared to the prior year, the Utilities would accept customer requests to revise MDN and in good faith entertain agreement to a revised MDN based on demonstrable evidence of the occurrence or the reasonably expected occurrence of a material change in that customer's usage

profile. The Utilities have asked that the Proposed Order be revised accordingly in their Exception No. 26 if the Commission grants their Exception No. 27.

One corollary finding from this settlement is that the Commission can find that the acceptance of fall injection targets by two of the Utilities' major large volume transportation suppliers in and of itself constitutes independent evidence of the need for and the reasonableness of such targets. A similar corollary finding from this settlement is that the Commission can find that the acceptance by two of the Utilities' major large volume transportation suppliers of a Maximum Daily Nomination (MDN) limit for Riders FST and SST during the April through October timeframe superimposed upon year-around MDQ injection limits, in and of itself constitutes independent evidence of the need for and the reasonableness of such limits.

Considering all of the foregoing, there is ample evidence in the record to justify the Commission's acceptance of a fall injection target of 70% on Peoples Gas' system and its acceptance of a fall injection target of 75% on North Shore's system, and the adoption of a Maximum Daily Nomination limit for Riders FST and SST during April through October equal to customer's average daily use in the comparable month in the prior year plus 0.67% (20% of AB divided by 30). The Proposed Order should be revised accordingly.

#### **5. Unbundled Storage Bank ("USB")**

The Proposed Order properly recommended the rejection of the Unbundled Storage Bank ("USB") proposal originally made by IIEC, Vanguard and CNE-Gas. As a result of the settlement discussed in the preceding section, both Vanguard and CNE-Gas have abandoned their advocacy of the USB proposal in the proceedings, leaving IIEC as its sole advocate.

IIEC continues to claim that its USB proposal is a proposal to have the Utilities offer an unbundled storage service to its transportation customers. IIEC's claim is patently wrong. USB

is a proposal for transportation customers to receive preferential and discriminatory access to Peoples Gas' lowest cost storage asset. Staff reached this conclusion quite early in these proceedings. ICC Staff Ex. 24.0 CORRECTED at 13. The Utilities' residential customers could just as meritoriously have claimed that they should be entitled to preferential access to Peoples Gas' lowest cost storage asset. In fact, RGS did argue for preferential CFY supplier access to Manlove. RGS Ex. 2.0 REV. at 8-9. Manlove Field is an asset, not a service. The Proposed Order correctly found that the Utilities must balance conflicting claims from all of their customer classes regarding access to storage, and that it is most appropriate that such access be shared by all customer classes.

IIEC argues that other Illinois utilities, such as Nicor Gas, offer an unbundled storage service to transportation customers. IIEC BOE at 6. Like the argument presented by Multiut concerning Nicor's Rider 25, this is a brand new argument on IIEC's part, and it cites no evidence in the record in support of it. The Utilities have not had the opportunity to examine Nicor's tariff or the rate design underlying the tariff for this issue, or to cross-examine IIEC's witness concerning the accuracy of this claim. This claim is untimely and should be rejected summarily. IIEC also complains about what it calls a storage service that Peoples Gas offered to Merrill Lynch. The record is clear, however, that in fact the Merrill Lynch transaction was a capacity release transaction of a purchased storage service, and that transaction was available to IIEC members via bid if they had wanted it. NS-PGL Ex. TZ-2.0 at 16-17. Thus, the Merrill Lynch transaction has no relevance to the issues here.

**6. Rider P-Pooling**

**b. “Super-pooling”**

The only issue which CNE-Gas and the Utilities have not been able to resolve through settlement involves super-pooling. Super-pooling allows aggregation of all of a supplier’s customer pools into a single pool for certain purposes. The Proposed Order approved super-pooling for the purposes of determining whether a supplier satisfies the Utilities’ fall storage inventory requirements, and it also approved the inclusion of “stand-alone” customer accounts in a supplier’s super-pool. However, the Proposed Order rejected CNE-Gas’ position that super-pooling also should be utilized for the purpose of applying unauthorized use penalties on critical days or imbalance account charges on supply surplus days.

While the Utilities originally opposed any form of super-pooling, the Utilities have relaxed their position and are willing to accept the form of super-pooling approved in the Proposed Order. The Utilities are not, however, willing to agree to CNE-Gas’ additional demand – rejected in the Proposed Order – that super-pooling be utilized for the purpose of applying unauthorized use penalties on critical days or imbalance account charges on supply surplus days. The Utilities have relaxed their unconditional opposition to Super-pooling in the belief that the determination in the Proposed Order represented a reasonable balancing of the interests of transportation customers and the Utilities’ administrative requirements. Adoption of CNE-Gas’ proposal would improperly disturb this balance and impose unreasonable and unnecessary complexity.

CNE-Gas supports its position by arguing that if the Utilities can implement super-pooling for the purposes of determining a supplier’s compliance with the Utilities’ November 30 storage injection targets, they can do so for the purposes of applying unauthorized use penalties on critical days and imbalance account charges on supply surplus days. That is true so far as it

goes, but there are additional factors that bear upon the matter. As the Proposed Order correctly found, the Utilities would only have to determine a supplier's compliance with the Utilities' November 30 storage injection target once a year, while critical and supply surplus days are temporally and quantitatively erratic, presenting the Utilities with billing system complexities that are best avoided. CNE-Gas speculates in its BOE that the Utilities could "simply [sum] all of the detailed calculations . . . to then net them across accounts and pools of a single marketer" (CNE-Gas BOE at 9). However, the fact that CNE-Gas admits that the calculations would be detailed itself supports the reasonableness of the Utilities' aversion to agreeing to perform them. CNE-Gas claims that critical days and supply surplus days are rare events. However, that does not change the fact that they are temporally and quantitatively erratic. The Proposed Order on the issue of super-pooling is completely consistent with the result in *Nicor Gas 2005*. Therefore, CNE-Gas' exception concerning super-pooling should be rejected.

**7. Operational Issues**

**b. Delivery Restrictions**

The Proposed Order would require the Utilities to create a formal tariff provision explicitly authorizing a process whereby a supplier could agree to reduce deliveries during a delivery restriction imposed by the Utilities in return for the Utilities' agreement to permit that supplier to return to required base load volume after a reduction, even while a delivery restriction continues. This is acceptable to the Utilities.

Multiut misinterprets the Proposed Order, stating that "it requires the Companies to create a tariff that addresses how the Companies may restrict deliveries." Multiut BOE at 9. The Proposed Order does not purport to compel the Utilities to spell out how they restrict deliveries;

it only deals with the issue of relief from a delivery restriction in instances in which a supplier temporarily reduces its deliveries to one of the Utilities.

The Utilities oppose Multiut's amorphous exception concerning delivery restrictions. The Utilities must balance inputs into and outputs from their systems on a real-time basis. The specific type of restriction and when and where it applies must be determined on a case-by-case basis. Moreover, the Utilities' Tariffs already include guidelines on the types of delivery restrictions that the Utilities may impose. For example, the "Operational Integrity" provision in the Terms and Conditions of Service specifies certain types of restrictions and requires the Utilities to provide notice two hours prior to the applicable nomination deadline. The Proposed Order reasonably directed the Utilities to include in their Tariffs the existing process for granting relief from delivery restrictions, and this straightforward addition does not require an extended review and comment process.

**8. Other Large Volume Transportation Issues**

**c. Cash-outs Index**

The Proposed Order approves the Utilities' proposals to sell gas to a customer at 110% of the AMIP to the extent that customer fails to satisfy its November 30 storage injection target. Multiut excepts to the Proposed Order by claiming that the storage injection target should be optional. Multiut BOE at 7-8. If the Proposed Order's fall storage injection targets, as modified in the case of North Shore pursuant to the settlement with CNE-Gas and Vanguard, are approved, Multiut's exceptions necessarily must be denied. Furthermore, because Multiut has not specifically excepted from the Proposed Order's finding that 110% of the AMIP is an appropriate price for the Utilities to charge a supplier who fails to satisfy its November 30

storage inventory requirement, Multiut is precluded from further complaint about that pricing provision.

**D. Small Volume Transportation Program (Choices for You<sup>SM</sup> or “CFY”)**

**1. Storage Rights and Aggregation Rights**

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

Evidently dissatisfied with the common briefing outline that the parties and the Administrative Law Judges previously adopted to organize the presentation of issues to the Commission, RGS has chosen to ignore that outline by bundling together presentation of small volume transportation issues X.D.1.(A), (B) and (E) of the Proposed Order, and by discussing (E) before either (A) or (B). RGS has done so in order to give the impression that the issues are under consideration as a package. Each of those issues is a distinct matter for separate decision. The Utilities’ discussion of these issues will adhere to the order of presentation of these issues in the Proposed Order, which decided all of them correctly.

RGS expends much energy arguing that the Utilities’ large volume transportation tariff Rider FST<sup>17</sup> affords customers greater storage and delivery rights than those accorded to customers under Rider AGG. That may be true, but it also is irrelevant. Riders FST and AGG are two very different services and have many provisions which differ between them. The administrative charges contained in these two riders differ materially. There is simply no reason why these two riders should have the same provisions concerning customer storage and delivery rights and RGS has certainly not offered any such reason into evidence. The Proposed Order, at

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<sup>17</sup> RGS erroneously claims that Rider FST Allowable Bank be filled to a certain percentage of capacity by “November 31.” RGS BOE at 10, 12.

276, correctly finds that the RGS proposal would necessarily require daily metering, an obligation and cost that RGS is unwilling to assume. This finding alone completely justifies the Commission's rejection of RGS' proposed Rider AGG.

RGS also claims that the Utilities' claim that they are responsible for handling customer consumption changes as a result of weather is misleading. RGS BOE at 8. Instead, it is RGS' argument that is misleading. The Utilities are obligated to provide 100% of CFY customers' requirements on a daily basis. The CFY supplier's obligation is to deliver to the Utilities the amount of gas that the Utilities forecast will be required by CFY customers. The requirements forecasting risk is placed squarely on the Utilities, not on the CFY supplier. NS-PGL Ex. TZ-2.0 at 49-50.

RGS also claims that the Proposed Order omits discussion of RGS' proposed Rider AGG and how RGS' proposal purportedly addresses the Utilities' concerns about it. RGS BOE at 11. This is patently wrong, as this issue is discussed in detail in the Proposed Order at 275-278.

**b. Aggregation Balancing Gas Charge (ABGC)**

RGS also excepts from the provision of the Proposed Order declining to eliminate or reduce each Utility's ABGC. The Utilities oppose RGS' exception on this issue. The Proposed Order correctly decided not to reduce or eliminate the ABGC, finding that it is an appropriately cost-based rate for which the Utilities supply approved services. The Utilities incur costs to provide the storage and balancing services that they do provide to CFY customers and the ABGC recovers these costs.

**d. Customer Migration**

The Proposed Order approved RGS' request for reallocation of storage during the withdrawal season to account for customer migration, but it did not adopt RGS' proposed text on this issue. Instead, the Proposed Order directed the Utilities to perform the storage reallocations

during the withdrawal season in the same manner that they will perform them during the injection season. Proposed Order at 280. The Utilities have not taken exception to this finding. They are willing to perform storage reallocations during the withdrawal season in, as nearly as feasible, the same manner in which they will perform them during the injection season. RGS has proposed complicated and convoluted text under which the Utilities would be required to account for customer migration. While the Utilities are willing to account for customer migration during the withdrawal season, they do not want to be compelled to do so in accordance with RGS' proposal. The Proposed Order grants the substance of the relief sought by RGS on this issue while minimizing the changes required of the Utilities to accommodate customer migration, which the Utilities already propose to do during the injection season. The Proposed Order's resolution of the customer migration issue should be adopted by the Commission as it stands.

e. **Month-End Delivery Tolerance**

The Proposed Order correctly accepted the Utilities' proposal to increase the month-end delivery tolerance from 2% to 5% of Monthly Adjusted Deliveries. RGS proposed to have no month-end delivery tolerance requirement. In pursuing that position, RGS wrongly claims that the Utilities have proposed "only a 3% increase in the month-end delivery tolerance." RGS BOE at 6, 9. Mathematically, an increase in tolerance from 2% to 5% is a 150% increase in tolerance. The Proposed Order correctly found that RGS has not rebutted the Utilities' and Staff's contentions that the Utilities themselves have month-end obligations under their leased storage contracts and that a further expansion of tolerance beyond that proposed by the Utilities would make fulfillment of those obligations more burdensome. Proposed Order at 281. Nothing in RGS' BOE refutes this finding.

RGS also complains about frustration in its attempts to negotiate issues with the Utilities, and claims that the Utilities simply refused to consider changes or offer alternatives in connection with its small volume transportation programs. RGS BOE at 18. These misleading *ad hominem* complaints about the Utilities should be rejected by the Commission. RGS Witness Crist admitted on cross-examination in these very proceedings that the Utilities had agreed to a number of revisions to their small volume transportation program during the past year based on negotiations with Mr. Crist and other CFY suppliers. For example, the Utilities eliminated a requirement for a CFY supplier customer meter number before the supplier could enroll a customer in the CFY program. Crist, Tr. at 1012. The Utilities also eliminated the minimum pool size of 50 accounts. *Id.* They also agreed to move the ABGC charge billing from the supplier to the customer. *Id.* The Utilities also agreed to drop the \$10 customer enrollment charge. *Id.* at 1013. The Utilities also agreed to provide a credit for working capital for the CFY aggregation charge. *Id.* The Utilities obviously have negotiated in good faith concerning this program. RGS simply is unhappy with the fact that the Utilities won't simply roll over and give into every RGS demand. The fact that the Utilities also concluded a settlement on a number of major issues with CNE-Gas and Vanguard provides further evidence of the Utilities negotiating in good faith with their transportation customers and transportation customer suppliers.

**2. Customer Enrollment**

**a. Customer Data Issues**

NAE excepts to a provision of the Proposed Order barring any “retransfer” of customer information for “purposes other than the provision of gas service.” NAE BOE at 1-2. The Utilities oppose NAE’s exception in this regard. NAE’s opposition to this provision is a strong indication that it intends to use access to customer data to harvest it for sale to marketers of

various products and services which may have little, if any, relation to gas service. The Utilities believe that this is an impermissible practice. Most consumers do not expect their contact data to be sold in this fashion – otherwise, the FTC’s “do not call” program would not be as popular as it is.

NAE also excepts to a provision of the Proposed Order permitting the Utilities to require compensation from CFY suppliers seeking access to Tier 2 data. The Utilities also oppose this exception. NAE wrongly claims that there “is nothing new” about the Utilities being required to receive and monitor customer consent to provide Tier 2 data to CFY suppliers. NAE BOE at 3. This is not true. The Utilities never have made Tier 2 data available to CFY suppliers. In order to make it available now, they will have to develop systems and processes for gathering it and supplying it consistent with the customer consent provisions which they must develop. These will be new procedures, and the Utilities will incur costs to implement them. The proposal should therefore be rejected.

**b. Evidence of Customer Consent**

NAE also excepts to the provisions of the Proposed Order concerning evidence of customer consent. NAE BOE at 4-5. The Utilities oppose NAE’s exception in this regard. The issue is simply too important for one party to be given the opportunity to complain about the procedures that the Utilities develop concerning evidence of customer consent. The Utilities submit that the record in these proceedings, which reflects numerous concessions made to RGS and the settlement of substantial issues with CNE-Gas and Vanguard, indicates that the Utilities will resolve issues concerning evidence of customer consent in a responsible fashion.<sup>18</sup>

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<sup>18</sup> All of the issues between NAE and the Utilities concerning Rider SBO also were resolved pursuant to a settlement between them.

#### **4. Purchase of CFY Supplier Receivables**

The Proposed Order correctly rejects the proposal of RGS to require the Utilities to purchase CFY supplier receivables of suppliers using the LDC billing option. Proposed Order at 288-290. The Utilities' Initial Brief and Reply Brief demonstrated that the proposal is seriously flawed for five reasons: (1) Peoples Gas and North Shore are not in the business of offering purchase of receivables service to third parties, do not wish to provide such service, and their information systems and business processes are not set up to provide this service notwithstanding RGS' incorrect speculation to the contrary ; (2) the proposal inappropriately would shift business risks from CFY supplies to the Utilities and utility customers; (3) the proposal unfairly and improperly as a matter of law requires the Utilities to invoke, and carry out, the threat of disconnection of their customers when they do not have balances owed for utility services; (4) the proposal as presented in the evidence in the record provides for no discount or other compensation for the Utilities to recover the administrative costs and the costs associated with the additional risks and the bad debt that is not collected; and (5) Senate Bill 1299, upon which RGS relies for support, was enacted but applies only to certain electric utilities and RGS did not even make the evidentiary record that would expressly required under Section 1299 if it were applicable. NS-PGL Init. Br. at 214-217; NS-PGL Reply Br. at 171.<sup>19</sup> Staff, in its Initial Brief, also opposed RGS' proposal because it would have the effect of "holding utility service hostage to payment of a bill for a competitive service." Staff Init. Br. at 264. Staff also opposed the proposal in its Reply Brief. Staff Reply Br. at 110.

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<sup>19</sup> The Utilities' Reply Brief also pointed out that RGS inappropriately was trying to supply missing pieces of, and revise, its proposal in briefing. NS-PGL Reply Br. at 169-170.

The Proposed Order correctly rejects RGS' proposal. As the Proposed Order recognizes, RGS' proposal, if adopted, would ultimately shift the burden of CFY bad debt to the Utilities' customers. Proposed Order at 289. The Proposed Order further recognizes that RGS' proposal would have the unwelcome result of attracting customers with unsavory credit histories. Proposed Order at 290. Such customers "would indeed enjoy broad choice under the RGS' zero discount POR, since neither they nor the CFY supplier would have any stake in their accountability." *Id.* The Proposed Order also correctly rejects RGS' argument regarding Senate Bill 1299, finding that the evidentiary record is "insufficient to establish either an appropriate discount or an increased revenue requirement." *Id.*

In response, RGS goes to great lengths to try to convince the Commission that its proposal would not shift the risk of CFY bad debt to the Utilities or its customers. RGS BOE at 25-28. That is simply not true. RGS cannot alter the fact that the Utilities do not now have the risks associated with collecting the receivables in question. NS-PGL Ex. LTB-3.0, at 9-10. Indeed, the answers of RGS' witness at the evidentiary hearing demonstrate that, while the CFY suppliers perform credit checks now, they would stop doing so if RGS' proposal were adopted, thereby shifting even more risks to the Utilities. *See Crist, Tr.* at 1023-1025. *See also* RGS Init. Br. at 33 (stating that, with a POR program, suppliers will not obtain customer payment histories of or perform credit checks as to potential customers, because the Utilities will have to guarantee that the suppliers will be paid). RGS' proposal further harms the Utilities' relationships with their customers by requiring the Utilities to invoke, and carry out, the threat of disconnection. NS-PGL Ex. LTB-2.0, at 15; NS-PGL Ex. LTB-3.0, at 10.

Although RGS' Brief on Exceptions touts the "numerous benefits" associated with its proposal, namely the elimination of certain obligations for CFY suppliers (RGS BOE at 23-24),

that misses the point entirely. The question is not whether CFY suppliers will benefit, but to what degree the Utilities and its customers will be harmed, and also whether forcing Utilities to invoke the threat of disconnection here is improper. They will be harmed, and it is improper. RGS further attempts to persuade the Commission that Senate Bill 1299 “provides a model for the gas industry” (RGS BOE at 24); however, this argument ignores two critical points. First, the General Assembly chose not to extend the requirement of a purchase of receivables program to gas utilities or even to all electric utilities. NS-PGL Ex. LTB-3.0, at 13. Second, RGS never made the showings required under Senate Bill 1289 even if it were applicable, as noted above.

RGS has presented no valid grounds to support its proposal, and there are no facts in the evidentiary record upon which the Commission could even implement its proposal. Moreover, the proposal is improper. Accordingly, the Commission should adopt the reasoning in the Proposed Order and reject RGS’ proposal.

## **XI. UNION PROPOSALS**

### **A. One-for-One Proposal**

The Proposed Order did make some findings that the ALJs were troubled by some of the Union Local 18007’s allegations regarding the use of temporary repairs. Peoples Gas disputes those findings, for the reasons set forth in its Brief on Exceptions. NS-PGL BOE at 85-86. However, the Proposed Order does not impose the Local’s draconian and rigid “One-for-One” proposal on Peoples Gas. That proposal is ill-considered and should not be forced on Peoples Gas, certainly not without much more concrete evidence of bona fide safety issues, evidence which is not in the record, and which Peoples Gas submits does not exist. The Local’s Exception (Union BOE at 1-2, *et seq.*) should be rejected.

First, the bald allegations of safety problems are truly insufficient to warrant the One-for-One hiring scheme. The Proposed Order in effect criticizes Peoples Gas for failing to provide sweeping detailed evidence that proves a negative. The Local offers up allegations that there are widespread safety issues, but offered a total of one example, and that example turned out to be a poor one, with no actual safety problem. (This is now referred to in the Local's BOE as "proven safety concerns." (Union BOE at 11)) How is Peoples Gas to "prove" that repairs are made safely and timely?

Second, the Proposed Order is correct to stop short of having the Commission order a utility to hire people into particular positions. That kind of command and control is not appropriate for a utility regulator. The utility should be free to manage its employees, hiring, firing, and using attrition, to get the utility's work done. If the Commission concludes, based on the thin evidence in this record, that there really are widespread safety concerns, then the Commission should order Peoples Gas to fix them. It should not specify the size of wrench, the type of pipe wrap, or the number and pay grade of employees to use on a repair.

This is particularly true in light of the competing concern of efficiency. While safety is no doubt paramount, a utility is charged with running an efficient operation to the benefit of those who pay its rates. The Local repeats with distaste that "today's workforce is doing more with fewer people." Union BOE at 4, quoting UWUA Ex. 1.0, at 10. But that phrase should not trouble the Commission as much as it does the Local. Doing more with fewer people is precisely what a well-run public utility should attempt to do, if it can be done safely and reliably.

Third, the Commission should not lose sight of the motivation of the Local to raise these concerns. The specific focus of the One-for-One plan is to make sure that there are as many union workers as possible in the very highest paid positions. In testimony, the Local's witness

made clear that their proposal is not to hire new people at entry level salaries, but to guarantee promotions to existing union employees to the highest positions. Gennett, Tr. 793:18-21. The One-for-One proposal is not so much about safety (and has nothing to do with efficiency); it has to do with ensuring more senior union workers.

**B. Audit Provisions**

The Local advocates the One-for-One program, which the Proposed Order does not implement. As a “cautionary exception,” the Local attempts to build the One-for-One program into the ordered audit as a fait accompli. Union BOE at 2. That is not appropriate. Peoples Gas has stated in its Brief on Exceptions (at 85-88) why the audit is not necessary. However, should the Commission decide to order the audit, the Commission should wait and see the results, and whether any action at all is, in fact warranted. The Local’s suggested language assumes that the audit will bear out its allegations, and that the One-for-One proposal is the natural and inevitable result. Peoples Gas continues to believe that is not the case.

**FINDING AND ORDERING PARAGRAPHS**

The Staff excepted to Finding (20), which sets forth the effective date of the compliance tariff sheets that the Utilities will file in these proceedings. The Staff proposed to increase the period from three calendar days to seven working days. Staff BOE at 90-92.

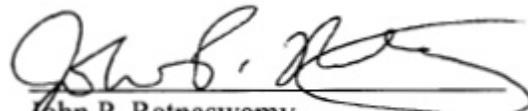
The Utilities agree that three calendar days may be too short a period for review, particularly if, to use the Staff’s example, a weekend falls in the period. However, extending the period to seven working days is excessive. The Utilities propose three working days as an alternative.

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



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