STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	
Proposed general increase in natural gas rates (tariffs filed March 9, 2007)	: : :	**Docket No. 07-0241**
	:	**(cons.)**
The Peoples Gas Light and Coke Company	: :	
	:	**Docket No. 07-0242**
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REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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December 21, 2007

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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (“Commission”), 83 Ill. Adm. Code Section 200.830, respectfully submits this Reply Brief on Exceptions to the briefs on exceptions (“BOEs”) filed by North Shore Gas Company (“North Shore” or the “Company”) and The Peoples Gas Light And Coke Company (“Peoples Gas” or the “Company”) (collectively referred to as the “Companies” or “Utilities”) (“the Companies’ BOE” or “Companies BOE”); The People Of The State Of Illinois’ BOE (“AG’s BOE” or “AG BOE”), The City of Chicago BOE Regarding Proposed Rider ICR (“City’s ICR BOE” or “City ICR BOE”), the BOE of The City Of Chicago And The Citizens Utility Board (“City-CUB’s BOE” or “City-CUB BOE”), the Constellation NewEnergy-Gas Division, LLC's BOE ("CNE-Gas' BOE" or "CNE-Gas BOE"); the BOE Of Environmental Law And Policy Center ("ELPC's BOE" or "ELPC BOE"); the Illinois Industrial Energy Consumers' BOE ("IIEC's BOE" or "IIEC BOE"), the BOE Of Multiut Corporation ("Multiut's BOE" or "Multiut BOE"), the BOE Of Nicor Advanced Energy L.L.C. ("NAE's BOE" or "NAE BOE"), the BOE Of The Retail Gas Suppliers ("RGS' BOE" or "RGS BOE"), the BOE Of Local Union No. 18007, Utility Workers Union Of America, AFL CIO ("UWUA's BOE" or "UWUA BOE"), and the BOE of Vanguard Energy Services, L.L.C. ("Vanguard's BOE" or "Vanguard BOE") which were filed on or before December 14, 2007 in response to the Administrative Law Judges' Proposed Order ("Proposed Order" or "PO") issued November 26, 2007.

II. RATE BASE

E. Cash Working Capital

1. Removal of Depreciation and Amortization

Staff agrees that Operating Expenses included in the cash working capital ("CWC") calculation should be reduced by depreciation and amortization expenses of $59,203,000 for Peoples Gas and $6,094,000 for North Shore. (*See* PO, page 11 of Appendix ("App.") A (Peoples Gas) and App. B (North Shore); Companies' BOE at 7-8) As explained by Staff witness Kahle, the non-cash items included in the Companies' revenues and expenses should be excluded from a CWC calculation because the purpose of the calculation is to determine the daily cash needs of the Companies. (ICC Staff Ex. 3.0 at 5-6; *see also* Peoples Gas Ex. MJA-1.0 at 19, lines 404–405; North Shore Ex. MJA-1.0 at 19, Lines 404-405) Staff's rebuttal schedules inadvertently omitted a deduction to Operating Expenses for depreciation and amortization. (See ICC Staff Ex. 15.0, Sch. 15.1 P at. 2 and Sch. 15.1 N at 2)

While Staff agrees that adjustments to deduct depreciation and amortization from the CWC calculation are appropriate, Staff believes that – for consistency of presentation and understandability -- the Appendices to the PO should be corrected by including an explicit deduction to Operating Expenses for depreciation and amortization instead of showing starting numbers for Operating Expenses that are adjusted for depreciation and amortization. Staff has attached to this Reply Brief on Exceptions appendices for CWC showing the corrections and changes that Staff believes are appropriate and consistent with the substantive conclusions reached in the Proposed Order. (Cf. Companies Exceptions at 5, 9; Staff RBOE, App. A at 2 and App. B at 2) Staff wants to be clear, however, that Staff in no way intends to waive or concede any of the arguments or positions taken in its BOE with respect to these issues.

2. Exclusion of Capitalized Payroll-Related Expenditures

The Utilities assert that the Appendices to the Proposed Order reflect mathematical errors in connection with implementing the Proposed Order's directives regarding capitalized payroll-related expenditures. (Companies' BOE at 5-6, 8-9) Staff agrees in part and disagrees in part with the Utilities' assertions. Obviously, capitalized payroll-related expenditures (included in the CWC calculation pursuant to Staff's proposed CWC adjustment to include capitalized payroll) should be removed from the CWC calculation under the Proposed Order's conclusion that capitalized payroll-related expenditures should not be included in the CWC calculation, Staff also agrees that the

Appendices to the Proposed Order do not fully remove capitalized payroll-related expenditures. The Utilities propose to remedy what they call mathematical errors by making adjustments or changes in the CWC calculation reflected in the Appendices related to the amounts for “Pension and benefits,” “Payroll and Withholdings,” and “Inter Company Billings.” (Companies BOE at 8-9).

With respect to expenditures for “Pension and Benefits” and “Payroll and Withholdings,” the Utilities have proposed an imprecise and less than optimal method of removing the capitalized portion of those expenditures from the CWC calculation. The calculation of the expensed <u>and</u> capitalized amount of expenditures for “Pension and benefits” and “Payroll and Withholdings” is presented on page 12 of App. A and App. B to the Proposed Order. Page 12 of each appendix is based on Staff’s schedules showing the total amount of these expenditures (i.e., including both expensed and capitalized amounts). To focus on Pension and Benefits for Peoples Gas for purposes of illustration, page 12 of App. A to Staff’s Initial Brief shows total Pensions and Benefits per Staff of $36. 991 million. This is calculated by taking the total Pension and Benefits (i.e., including expensed and capitalized amounts) reported by the Company on Schedule C-11.3 (see line 1), adding pro forma <u>operating expense</u> adjustments for Medical & Insurance Cost Adjustment and Pension Cost Decrease (see lines 2 and 4), and adding the capitalized amounts of Medical & Insurance Cost Adjustment and Pension Cost Decrease (see lines 3 and 5).

The Proposed Order focuses on page 12 of App. A to implement its decision to exclude capitalized expenses for these payroll-related items, and specifically does so by eliminating the additions for the capitalized amounts of Medical & Insurance Cost

Adjustment and Pension Cost Decrease that were shown on lines 3 and 5. What Appendix A to the Proposed Order does not reflect, however, is removal of the amount of capitalized expenditures included in the Pension and Benefits reported by the Company on Schedule C-11.3 and included on line 1 of Appendix A. Although the amounts are different, the same exact pattern is repeated for "Direct Payroll" (called "Payroll and Withholding" on page 10 of App. A to the PO) and for North Shore (App. B).

A full and correct implementation of the Proposed Orders directives would require adjustment of the amounts on lines 1 and 7 of page 12 of App. A and App. B to the Proposed Order remove the capitalized portion of those amounts. Unfortunately, the capitalized portions of those amounts are reflected on Schedules C-11.3 and C 11.1, and it does not appear that those schedules were introduced into the evidentiary record by the Utilities or any other party of Staff.

The Utilities propose to implement the Proposed Order's conclusion on capitalized payroll-related expenditures by utilizing the "Pension and Benefits" and "Payroll and Withholdings" amounts shown on page 11 of the Appendices (e.g., $31.011 million for Pensions and Benefits for Peoples Gas). Each page 11 of the Appendices reflects the amount of such expenditures included in operating expenses as reported by the Utilities on various schedules. While these amount are not fully comparable to the amounts reflected on page 12 of the Appendices, they do represent the amounts reported by the Utilities (and removed from the operating expenses approved by the Proposed Order and included in the CWC calculation so as to avoid double counting). Given the lack of record evidence to fully remove capitalized payroll-related expenditures from page 12 of the Appendices as discussed above, and the fact that the amounts on page 11 of the Appendices should generally equal the amounts that would result from a fully adjusted page 12, Staff does not object to use of the “Pension and Benefits” and “Payroll and Withholdings” amounts listed on page 11 of the Appendices for purposed of implementing the Proposed Order’s conclusion on capitalized payroll-related expenditures. Staff has also adjusted the amounts shown on page 12 to achieve the expensed amounts for “Pension and Benefits” and “Payroll and Withholdings” reflected on page 11 of each appendix.

The “Inter Company Billings” amount that the Utilities propose to adjust has nothing to do with capitalized payroll-related expenditures and in no way represents a mathematical error or correction. The amounts of Inter-Company Billings on pages 10 and 11 of each Appendix are taken from the Companies’ Summary of Affiliated Interest Transactions (Schedules C-13, Page 1 of 2, Column C, Line 14). There is no indication that any portion of these amounts has been capitalized. These amounts have been uncontested by any subsequent testimony until the Companies’ BOE, and then only as a mathematical error related to capitalized payroll-related expenditures. The Utilities are simply in error, a fact evidenced by the absence of Inter-Company Billings on the page 12 calculations of capitalized payroll-related amounts. Further, as can be seen on pages 10 and 11 of each Appendix to the Proposed Order, the amount of Inter-Company Billings removed from Operating Expenses on page 11 and included in the CWC calculation on page 10 is identical. The breakout of Inter-Company Billings provided for application of the specific lead for Inter-Company Billings, which differs from the lead for Other Operations and Maintenance (see page 10 of each Appendix to the PO). Staff also notes that the deductions for Inter-Company Billings from Operating

Expenses in NS-PGL Ex. MJA-2.1 are identical to the deductions from Operating Expenses on page 11 of the Appendices to the PO.

Thus, contrary to the Utilities exceptions, and for all the foregoing reasons, the amounts reflected for Inter-Company Billings in the Appendices to the Proposed Order are not the result of any mathematical error, do not relate to the capitalized payroll-related expenditures, and are not the subject of any substantive exception raised by the Utilities. Therefore, the Utilities exception to correct a mathematical error for this amount must be denied.

3. Incorporation of Pass Through Taxes

The Utilities explicitly state that they are not filing Exceptions to the CWC "discussion, analyses, and conclusions included in the text of the Proposed Order." (Companies BOE at 5). Rather, they refer to their motion to correct mathematical errors and indicate that they do take Exception to mathematical errors in the CWC calculations included in the Appendices to the Proposed Order. (*Id*. at 5-6) Staff does not agree with the assertion in the Companies' BOE that the Appendices to the Proposed Order contain mathematical errors related to the Proposed Order's decision regarding pass through taxes. (Companies BOE at 5-6, 9-10)

There are no math errors in the CWC calculation related to pass-through taxes. The Companies are proposing changes in methodology that are not supported by the record, and which are not part of a proper Exception. The revenue lag days were calculated from services: the delivery of gas verses the receipt of payments from customers. No calculation of lag days for pass-through taxes is in the record. Even if there was a lag associated with pass-through taxes, one cannot assume the lag days for revenue would be the same for pass-through taxes without analysis.

The lag days for pass-through taxes are zero since there is no delivery of service date to measure against receipt. Per the direct testimony of Companies' Witness Adams, "The revenue lag reflects the time between the date customers receive service and the date that customers' payments are available to the utility. (Page 3 of 20 Peoples Gas Ex. MJA-1.0) With this definition, there can never be a revenue lag for pass-through taxes because there is no "date customers receive service" related to receiving pass-through taxes.

The Utilities' Exception based on an alleged mathematical error should be denied because there is no mathematical error and they have failed to raise any other substantive Exception.

1. Mathematical Error in Peoples Gas NS-PGL Exceptions to the Proposed Order

Staff also notes that on Appendix A, page 10, of the Companies' Exceptions it has proposed an adjustment to **increase** Peoples Gas' CWC requirement by $5,947,000 through a mathematical error. While Staff does not accept this calculation of CWC, the correct calculation would be a **decrease** to the CWC requirement of $5,947,000: $24,949,000 - $30,896,000 = $(5,947,000).

4. Clarification

On each page 11 of the Appendices to the Proposed Order, line 10 is mislabeled. Line 10 should be labeled "Operating Expenses"_since the amount includes Operation and Maintenance ("O&M") accounts, as well as administrative and general, and all other operating expenses such as taxes other than income and depreciation expense. Limiting the title to O&M is inaccurate.

5. Summary of CWC Calculation Corrections

In summary, and as explained above, the PO's CWC calculation should be modified to reflect the removal of depreciation expense from Operating Expenses and the removal of the capitalized portion of "Pension and Benefits" and "Payroll and Withholdings" expenditures. No other changes should be made to the CWC calculations with respect to the alleged mathematical errors. Revised CWC calculations reflecting the appropriate corrections are provided on the attached ICC RBOE Appendices A and B.

Staff prepared RBOE Appendices A and B based on the conclusions reached in the Proposed Order. However, Staff maintains its position that all cash flows associated with the Companies' day-to-day operations, including capitalized payroll, pensions and benefits, should be included in the CWC requirement calculation (Reply Brief at 5 and BOE at 7).

F. Gas in Storage

1. Working Capital

The Companies dispute the PO's conclusion that their working capital allowance for gas in storage should be reduced by the amount recommended by Staff (Peoples Gas' allowance by $13,549,797 and North Shore's allowance by $1,422,772). (NS-PGL BOE at 11) The Companies do not dispute that they had more gas in storage in the test year then in prior periods, and that the Companies actual storage levels exceeded their planned storage levels. (Id. at 11-12) Thus, the Companies' brief on exceptions does not disagree with the sound reasoning found in the PO to disallow the Companies' excess cash working capital associated with gas in storage. The Companies instead continue to claim that the Commission has missed the point that the unusually high test year storage volumes were not a genuine issue, further noting that all gas storage in Manlove is either base gas or top gas and the Companies should therefore received a return on this gas. (Id. at 11) The Companies also claim that the fact that all of the gas is not cycled does not mean the gas does not exist and if the gas exists then the Companies should receive a return on this gas. (Id.) However, the Companies failed to demonstrate that their test year totals were representative of the cost they would incur going forward. Therefore, the PO properly recognized that Staff's approach followed proper ratemaking policy by normalizing the Companies excessive test year totals to normal levels, therefore, Staff continues to disagree with the Companies arguments and supports the PO's conclusion.

Staff's analysis demonstrated that Peoples Gas' requested test year gas volume was on average more than 4 Bcf[1] higher than the prior two fiscal years (Fiscal 2005 and 2004) and more than 10 Bcf higher than Fiscal Years 2003 and 2002. (ICC Staff Exhibit 11.0 at 7-8 and ICC Staff Exhibit 11.0, Schedule 11.3P) North Shore's requested test year gas storage volume was about 900,000 Mcf higher than the storage volume from the prior 4 fiscal years. (Id. at 25) Staff's analysis of historical storage volumes coupled with the Companies agreement that its storage volumes were higher than normal due to the much warmer than normal temperatures in the test year led Staff to conclude the Companies requested amounts were not based on normal conditions as required by the

[1] Bcf is equal to 1,000,000 Mcf or 1,000,000,000 cubic feet.

Commission's test year rules. (Staff Ex. 23 at 8, 17; *see also* A. Finkl & Sons Co. v. Icc, 250 Ill. App.3d 317, 325 (1st District. 1993) ("The test year so selected is intended to be representative of both the utility's anticipated rate-base expenses and its expected revenues.") Staff therefore properly argued that the revenue requirement determined in the instant proceeding should be based upon normal conditions. (Id.) Thus, Staff's adjustment results in the normalization of the Companies requested amounts as required by the Commission's test year rules.

The PO's conclusion to rely on Staff's normalized amounts is also consistent with the requirements of the PUA and prior Commission practice. Pursuant to Section 9-101 of the Act, the Companies are only allowed to charge just and reasonable rates. (220 ILCS 5/9-101) In setting those rates the Commission has historically viewed larger than normal values for gas in storage as not just and reasonable. For example, Staff has previously reviewed the working capital allowances for a gas utility and found the test year volumes for that utility were larger than historical levels due to warmer winter weather. Staff concluded those test year amounts were higher than normal and recommended to the Commission that they be adjusted downward. (ICC Docket Nos. 02-0798, 03-0008, 03-0009, October 22, 2003 Order, p. 21) Further, the Commission agreed with Staff's arguments that the storage inventory levels were excessive and to achieve a more normalized rate base, reduced the working capital allowances associated with gas in storage. (Id. at 22) Therefore, the Companies' claim that Staff's adjustment is not a genuine issue ignores the necessity to normalize rates to ensure those rate are just and reasonable and ignores prior Commission actions and the test year rules.

Finally, the Companies arguments only address inventory volumes at Manlove field and do not consider leased storage. (NS-PGL BOE at 12) However, the record clearly indicates that Staff's analysis relied on normalized storage levels to determine each Companies working capital allowance for gas in storage and considered three leased storage services in addition to Manlove field for Peoples Gas (Staff Ex. 23.0, Schedule 23.2P) and considered two leased storage services in addition to Manlove field for North Shore. (Staff Ex. 23.0, Schedule 23.2P) The Companies' attempt to muddy the discussion by solely addressing its concerns regarding Manlove is disingenuous and the Commission should give it no weight. Therefore, the Commission should reject the Companies' arguments and retain the PO's conclusions as written.

2. Accounts Payable

Staff does not agree with the Companies' BOE regarding the reduction of accounts payable associated with gas in storage. (Companies' BOE at 13 - 14) Staff continues to agree that the PO appropriately deducts accounts payable associated with gas in storage from rate base. The Companies' argument that there are no accounts payables ("AP") associated with gas in storage is absurd since the Companies' response to Staff data request DGK-14.07 quantified the amount of AP associated with gas in storage. (ICC Staff Exhibit 3.0-Supplemental Corrected at 3) In addition, the Companies' own CWC calculations measured an expense lag for gas purchases of 42.05 days for Peoples Gas and 41.84 days for North Shore. The Companies' BOE states that invoices are paid within 16 days of receipt, but omits any discussion of the lead time from the provision of services to the receipt of the invoices. The Companies have offered no evidence that refutes their own calculation of expense lead times for gas purchases. In his direct testimony, the Companies' Witness Adams explains the leads associated with the Company's purchases of gas where he states "…that companies providing pipeline services typically send out invoices around the 10th of the month following the service month with payments due 10 days later. Commodity supplier payments, on the other hand, are typically due around the 25th of the month following the supply month". (Peoples Gas Ex. MJA-1.0, Page 8, Lines 153 – 163) With Witness Adams' direct testimony that the expense lead time associated with payments for fuels including pipeline services includes 15.21 days of service lead time (Peoples Gas Ex. MJA-1.0, Page 8, Lines 153 – 163), this confirms that accounts payable exists for 26.84 days in the average month after deducting the service time from the expense lead time (42.05 days less 15.21 days = 26.84 days for Peoples Gas) The Companies offer no explanation of how paying invoices within 16 days of receipt mitigates the existence of the accounts payable prior to the payment of invoices.

The Companies are correct that Staff does not dispute that the Company eventually pays their invoices but that is no different then other expense included in a working capital adjustment. And while the Companies' BOE sixteen-day-period is at odds with the Companies' CWC calculations, Staff can find no logic that leads to a conclusion that paying an accounts payable within any timeframe, means that the accounts payable did not exist.

Simply, the amount of gas in storage associated with accounts payable should be deducted from rate base because that amount of gas in storage was not financed by investors.

G. OPEB Liabilities and Pension Asset/Liability

In testimony and briefs, Staff and the Companies have disagreed on the proper treatment of pension and OPEB assets and liabilities for ratemaking. Staff asserts that proper ratemaking requires accrued OPEB liabilities to reduce rate base and also requires pension assets/liabilities to be excluded from rate base. The rationale behind this treatment is very simple—it is based on who supplied the funding for these plans. Staff asserts that since pension and OPEB expenses have been and still are reflected in rates, it is ratepayers who supply the funds the Companies ultimately contribute to the pension and OPEB plans. Absent a demonstration that shareholders somehow provide the contributions to these plans (and there is no such demonstration in the record of the instant proceeding), it is ratepayers who supply the revenues the Companies use to operate, including making the required contributions to their pension and OPEB plans when those contributions are paid. Regardless of the timing difference between collection of the pension and OPEB expense that is reflected in utility rates and the later payment of that obligation through a contribution to the plans, the original source of funds is the ratepayer. For this reason, it is improper to reflect pension contributions or pension assets in rate base because such treatment would allow shareholders to earn a return on ratepayer-supplied funds. For this same reason, it is also proper to reduce rate base by the amount of accrued OPEB liability. This liability represents the expense that has been reflected in rates and collected from ratepayers, but not yet contributed to the OPEB plan by the Companies. Therefore, it represents a cost-free source of capital to the shareholders and must be a reduction of rate base.

In testimony and briefs, the Companies have argued that the pension asset for Peoples Gas and the pension liability for North Shore must also be reflected in rate base if the OPEB liability is reflected in rate base. Yet, they have failed to provide any rationale to support this treatment or to refute Staff's reasoned arguments.

The PO concluded correctly that rate base should be reduced by the accrued liability for OPEB expenses, $7,094,000 ($4,074,000 net of related deferred taxes) for North Shore and $55,653,000 ($31,570,000 net of deferred taxes) for Peoples Gas. (PO, p. 35) As Staff indicated in testimony and briefs, this treatment is proper because ratepayers, not shareholders, supplied the funds for OPEB obligations. For this same reason, Staff took exception in its BOE to the PO's conclusion that the contributions of North Shore and Peoples Gas to the pension plan during the test year in the amounts of $1,862,247 and $15,278,614, respectively, should offset the rate base reduction of the accrued liability for OPEB expenses. The PO incorrectly concluded that recognition of the pension contributions is necessary for fairness, but such treatment would actually result in a double recovery from ratepayers since it was ratepayers and not shareholders who contributed the funds.

In their BOE, the Companies assert that ratepayers have benefited from the Utilities' contributions to the pension plans but they offer no explanation to support this argument. As Staff pointed out in its BOE, the mere fact that the Companies paid their pension obligation with the funds they had collected from ratepayers is no reason to allow shareholders to earn a return on those funds by adding the pension contributions to rate base. Similarly, because OPEB liabilities are paid for with ratepayer supplied funds, shareholders should not be entitled to earn a return on those funds.

The only additional argument the Companies put forth in their BOE is the assertion that the Companies recorded pro forma adjustments to reflect lower levels of pension expense in fiscal year 2007. This assertion has nothing to do with treatment of the pension contributions. As Staff has repeatedly argued in testimony and briefs, the pension expense is and has been reflected in utility rates. The pension expense is based on actuarial calculations that recognize an amount of pension cost for that period. Contributions to the pension plan represent payments of that obligation with monies provided through the collection of utility revenues from ratepayers. In the absence of a demonstration that shareholders provided such funds, these contributions are funded by the ratepayers. In their BOE the Companies have simply repeated that they made the pension contributions as required and also recorded a pro forma adjustment to reflect a change in pension expense. Neither assertion provides a rationale to support inclusion of the pension asset/liability in rate base.

The Companies request that the Commission either deny the accrued OPEB liability reduction from rate base or, alternatively, allow it only if the Peoples Gas pension asset and North Shore pension liability are also included in rate base. A third alternative is also advanced by the Utilities if the previous two alternatives are denied—that is to maintain the incorporation of pension contributions as a reduction of rate base, as reflected in the PO. None of these alternatives makes any theoretical sense, as Staff has repeatedly explained in testimony and briefs. Nor does the Companies' allegation that Staff's arguments are one-sided carry any meaning. Throughout testimony and briefs, Staff has extensively responded to the position taken by North Shore/Peoples Gas witness Kallas (North Shore/Peoples Gas Ex. LK-2.0 and LK-3.0). In response to Staff's thorough and well-reasoned explanation of the treatment Staff proposes, the Companies have provided no basis for their position. They have attempted to link the treatment of accrued OPEB liability to the treatment of the pension asset without providing any rationale whatsoever to support their argument. Accordingly, Staff urges the Commission to: (a) reduce rate base for the accrued OPEB liabilities of North Shore and Peoples Gas; and (b) to eliminate pension assets, liabilities and contributions from rate base since those contributions were supplied by ratepayers.

III. OPERATING EXPENSES

C. Contested Issues

3. Administrative & General Expenses

b. Incentive Compensation Expenses

The Company's assertion that offering incentive compensation plans allows it "to attract and retain a qualified workforce" is not , in and of itself, sufficient reason to allow these expenses to be recovered from ratepayers. (PO, p. 66) Rather, a utility must demonstrate a link between these unique expenses and ratepayer benefits. Staff strongly agrees with this conclusion and also agrees that the STIC, Affiliate Charges, Restricted Stock and Performance Shares fail to demonstrate the cost saving or other direct ratepayer benefits that the Commission generally requires. (Id.) For the reasons stated in its BOE, Staff disagrees with the PO's conclusion that portions of the TIA Plan and all of the IPB Plan should be recovered through rates.

The Companies have taken exception to the PO by requesting that the Commission approve recovery of all incentive compensation program costs and expenses reflected in the Utilities' proposed revenue requirements. Their primary argument for recovery of incentive compensation costs is that no witness challenged the assertion that these costs and expenses are needed in order to attract and retain high-quality employees and in sufficient numbers. They further argue that no witness challenged the prudency and reasonableness of these costs or the assertion that these costs benefit customers by “maintaining and improving the productivity and quality of work”.

As the Companies well know, the Commission has never found this to be a compelling argument for recovery of these costs. Further, the lack of demonstration of ratepayer benefits is a challenge to the prudency and reasonableness of charging these expenses to ratepayers. Accordingly, Staff argued extensively that costs of such incentive programs should not be recovered from ratepayers unless the Utilities demonstrate that the programs provide direct ratepayer benefits and/or cost savings, the bases upon which the Commission has traditionally relied in deciding whether recovery of incentive compensation costs is appropriate. The Utilities’ argument that no witness challenged the prudency and reasonableness of these costs or the assertion that these costs benefit customers by “maintaining and improving the productivity and quality of work” is untrue. Because the Companies’ incentive compensation plans do not meet the well-established standards set by the Commission for rate recovery, the Utilities have cleverly attempted to establish a new (and more subjective) standard as put forth by their witness. Throughout the course of this proceeding Staff refuted the Utilities’ arguments by framing the issue in terms the Commission has historically used. Because the Companies were not able to adequately respond to Staff’s arguments, they now attempt to frame the issue in a manner different than what has been historically required for ratepayer recovery. First, the Companies conveniently lump all the cost of all the incentive compensation plans together in spite of the fact that Staff reviewed each plan separately and provided extensive testimony as to why each plan fails to meet the requirements for rate recovery. Several of the plans and/or measures within those plans provide absolutely no benefit to ratepayers and/or directly benefit the shareholders. Only one plan-- the TIA Plan-- contained some measures that might be construed to provide ratepayer benefits. The evidentiary record contains no demonstration that the IPB Plan provided any direct benefit to ratepayers. The other plans that were removed from the revenue requirement in the PO are based on criteria that primarily benefit shareholders.

For all the reasons contained here and in Staff's testimony and briefs, Staff urges the Commission to disallow the costs of all incentive compensation plans from the revenue requirements of the Utilities.

IV. RATE OF RETURN

C. Cost of Common Equity

In its BOE, the Companies criticized the PO's conclusions on cost of equity and proposed numerous changes for incorporation into the Post Exceptions Proposed Order ("PEPO"). The Companies' BOE focuses on a few issues and largely reiterates the same arguments the Companies previously lodged, which Staff has addressed. However, the Companies make several statements that warrant further response. Staff believes that none of the Companies' exceptions to the PO are valid and that none of the changes the Companies proposes should be incorporated into the PEPO.

Response to Companies Exception No. 12

The Companies set forth approximately five pages of exceptions language to the PO under the guise of simply making corrections necessary to ensure the parties' positions are stated accurately. (Companies BOE at 20; Companies Exceptions at 22-

26) Staff takes issue with the statement that the Companies are merely stating parties' positions accurately. The Companies' exceptions predominantly are an attempt by the Companies to have Staff's position restated in such a manner that is more beneficial to the outcome that the Companies desire. Since the Companies are not simply correcting misstatements of parties' positions, the Companies should have presented arguments to support those exceptions. In addition, the Companies have failed in their attempt to "accurately state" Staff's position.

One example of the Companies failing to accurately state Staff's position is the Companies' proposed language which states that "Staff estimated the Utilities market-based cost of equity based on the Utility Sample to be 9.79%" (Companies Exceptions at 22) (emphasis added). That statement is not true. As the PO correctly noted, Staff estimated the Companies market cost of equity to be 9.70% for Peoples Gas and 9.50% for North Shore (PO at 81). Those market based cost of equity estimates were made up of two parts. The first part was a sample cost of equity of 9.79% which was then adjusted downward by a second part, by 29 basis points for Peoples Gas and 9 basis points for North Shore, in order to reflect the lower risk of the Companies relative to the sample. (ICC Staff Exhibit 6.0 at 16) Therefore, it is not accurate for the Companies to suggest to the Commission that Staff estimated the Companies market-based cost of equity to be 9.79%. Again, Staff has separate market based cost of equity recommendation for each of the Companies, not one market based cost of equity for both Peoples Gas and North Shore as the Companies imply. Accordingly, this exception should be rejected.

The Companies go on in their exceptions to bolster their position by including their rebuttal to Staff's positions in the Staff position section of the PO. The Companies' support for this language again is that they are merely making corrections to accurately state the parties' positions. A review of the exceptions shows that to not be the case. For example at page 23 of the Companies Exceptions, the Companies propose the following language "The Utilities argue that the proximity of the averages is a meaningless coincidence, and diverts attention away from the wide disparity between Staff's CAPM and DCF results." (Companies BOE at 23) That statement is unnecessary and does not at all represent a fair statement of Staff's position, which is to point out that the difference between the average of Mr. Moul's CAPM and DCF analysis and the average of Ms. Kight Garlisch's CAPM and DCF analysis is only 11 basis points. That language is more in the nature of the exceptions language included in the Companies' exception No. 13. That language should have been supported by argument and not the statement that it's merely stating the parties' positions accurately. Accordingly this language should be rejected.

Staff would acknowledge that the last exceptions language at page 26 is an attempt to accurately state Staff's position, but the Companies' attempt falls short. Staff offers correcting language to that part of the PO elsewhere in the reply brief on exceptions.

<u>Response to Companies Exception No. 13</u>

<u>Staff's DCF</u>

The Companies argue that Staff's DCF results should be disregarded because they "vary too widely and include rates of return that approach and even fall below the utility cost of debt." (Companies BOE at 21.) First, Staff's lowest DCF result was 5.91%, which is higher than the cost of debt for both PGL and NS of 4.67% and 5.39%, respectively. (ICC Staff Ex. 6.0, Schedule 6.6; PO at 76) In addition, while the DCF cost of common equity estimate for Nicor is below the current yield on A-rated public utility bonds, individual DCF estimates for other sample companies are well-above the yield on A-rated public utility bonds. The Companies fail to recognize that the average cost of common equity for the sample is reasonably above the yield on A-rated utility bonds. (Staff RB at 28- 29) Based on the foregoing, the Proposed Order was clearly correct to adopt Staff's DCF recommendation.

The Companies contend that the Commission should disregard Staff's DCF analysis due to the "wide disparity" in the results. (Companies BOE at 27-28) The Companies' arguments are without merit. Staff relied upon an average of the DCF results, and not on an individual company estimate for its DCF estimate of the cost of common equity. Interestingly, the Companies find no problems with the results of the CAPM, in which there is greater disparity between the low and high results when using Value Line ("VL") betas. Staff presented the VL beta estimates for each company in the sample.[2] (Staff Ex. 6.0, Schedule 6.7) The lowest VL beta is .7, the highest is 1.3. The CAPM cost of common equity estimate for a .7 beta (South Jersey Industries), using the risk-free rates and market rate of return shown in Schedule 6.6 is 10.91%. The CAPM cost of common equity estimate for a 1.3 beta (Nicor), using the risk-free rates and market rate of return shown in Schedule 6.6 is 16.01%. The difference in the cost of

[2] Staff calculated a regression beta for the sample as a group but not for the individual companies in the sample.

common equity estimates associated with the highest and lowest betas is 5.1%. The difference in the highest and lowest individual company DCF estimates (Atmos Energy and Nicor) is 3.84%. (Id., Schedule 6.5) By the Companies' logic, it is the CAPM that should be rejected and the DCF retained, not the other way around. Of course, Staff recommends using both models, due to the measurement error inherent in estimating the cost of equity that invariably arises due to the use of proxies for unobservable investor expectations in both the DCF and CAPM.

Further, the Companies recommend that the Commission consider the results from their risk premium ("RP") model, since "the Commission accepted an analyst's cost of equity recommendation in the Commonwealth Edison rate case that was an average of the analyst's DCF, CAPM and RP results." (Companies BOE at 29) The Companies recommendation is faulty. First, the PO has specifically rejected the Companies RP model. In addition, the Companies have not shown that their risk premium model is the same as that utilized in the ComEd rate case (Docket No. 05-0597). Also, the analyst's cost of equity recommendation from the ComEd case was not an average of his DCF, CAPM, and RP results. Mr. Gorman, the analyst from the ComEd rate case, recommended a return on equity ("ROE") of 9.9% based on his DCF of 9.7%, CAPM of 10.2%, and RP of 10.2%. Mr. Gorman apparently gave the DCF equal weight to his CAPM and RP combined, because an equal weighting of all three analyses would have resulted in a 10.1% cost of common equity recommendation. Also, because his CAPM and RP were identical, eliminating one or the other would not change the result. (Order, Docket No. 05-0597 at 150) In addition, Staff and IIEC's recommended costs of common equity were relatively close and the two parties presented "minimal arguments against each other. (Id. at 155) That is not the case here. The Companies' RP result is not close to Staff's recommended cost of common equity and Staff presented sufficient arguments for the Commission to reject the Companies' RP analysis. (ICC Staff Ex. 6.0 pp. 31-32; IB at 70-71) Staff would further add that the Commission did not include Mr. Gorman's RP analysis in its authorized ROE in Docket Nos. 06-0070/06-0071/06-0072 (Cons.). (Order, Docket Nos. 06-0070/06-0071/06-0072 (Cons.) at 132-133 and 148)

Companies Market to Book Adjustments

The Companies contend that the PO "reflects a misunderstanding of the Utilities' proposed financial leverage adjustment." (Companies BOE at 22) There is no misunderstanding. The PO already considered and properly rejected the Companies' financial leverage adjustments, which Staff fully addressed in its Initial Brief. (PO at 92-93; Staff IB at 61-65) Thus, the Companies cost of common equity does not need to be adjusted to account for the difference between the market value and the book value of its common equity. The Commission has rejected use of the leverage adjustment in Docket Nos. 01-0528/01-0628/01-0629 Consol., 99-0120/99-0134 Consol. and 94-0065. The Commission should again reject the Companies market to book adjustments. The Companies state that their market-to-book adjustment is not "the type previously rejected by the Commission." (Companies BOE at 22) The Company is wrong. As with previous arguments that have been rejected by the Commission in past cases, the Companies' market to book adjustment is based on the false argument that an adjustment to a cost of equity estimate derived from a market value of equity is necessary when that estimate is to be applied to book value of equity to determine utility rates.

Staff's Financial Risk Adjustment

The Companies assert that "the record does not support Staff's specific 'financial risk' adjustments." (Companies BOE at 22) The Companies claim is baseless. The record evidence supports the PO's adoption of Staff's financial risk adjustment. (PO at 93-94) Staff provided a detailed analysis that demonstrated the necessity of the financial risk adjustment and how it was determined. (Staff IB at 54-58) Staff used the benchmark ratios as a measure of the financial strength the Companies would have the opportunity to attain given their level of business risk and the impact of Staff's proposed revenue requirement and capital components and costs in this proceeding. The Commission should not ignore the level of financial strength implied by the benchmark ratios in comparing the riskiness of the Companies versus the proxy sample. Ignoring the significant risk differential between the Companies and the Utility Sample, as the Companies espouse, would clearly be inappropriate. The funds from operations ("FFO") interest coverage ratios and FFO to total debt coverage ratios for each of the Companies indicate that Staff's proposed rates are sufficient to support financial strength that is commensurate with a credit rating of AA for North Shore and AA- for Peoples Gas. Further, the Companies' imputed total equity to total capital ratio of 56% is at the higher end of the benchmark range for an AA credit rating. In contrast, the Utility Sample's average total equity to total capital ratio of 46% is at the lower end of the benchmark range for an A credit rating. Since the Companies' implied forward-looking credit ratings are higher than the average A S&P credit rating of the Utility Sample, a downward adjustment is necessary to reflect the basic tenet of financial theory -- the investor-required rate of return is lower for investments with less exposure to risk. (ICC Staff Exhibit 18.0 at 4-5) In addition, the Companies current S&P credit rating is affected by its non-regulated affiliations and is therefore not reflective of its stand alone risk. (Staff IB at 54-58)

Next, the Companies claim that Staff should have adjusted the credit ratings of some of the sample companies the same way it adjusted their business profile scores. (Companies BOE at 34) The Companies are wrong. No adjustment to the credit ratings of the sample companies for which Staff relied upon the credit rating of their subsidiary was necessary, because the credit rating assigned to their subsidiaries already reflected the rating of the parent company. (Staff Ex. 6.0, Schedule 6.1)

Further, the Companies claim that there is a large difference between Staff's forward-looking assessment of the Companies' financial strength and the Companies' current credit ratings, which was why the same adjustment was "found unreasonable in Ameren." (Companies BOE at 22) The Companies are wrong. First, the circumstances in the Ameren rate case were unique and different then in the current cases. The Commission determined that it was not appropriate to isolate the delivery service operations risk from the risk associated with electric supply in order to comply with Section 9-230 and if one were to do that it would understate the delivery services operation's cost of capital. . (Docket Nos. 06-0070/06-0071/06-0072 (Cons.), Order dated November 21, 2006 at 147) The Commission found that supply risk or at least a part of it should be considered in the regulated companies risk because the Commission was not convinced by Staff that all of the incremental supply risk resulted from non-utility or unregulated companies. (Id.) Contrary to the Ameren case, the Companies credit ratings are impacted by their affiliation with unregulated companies but unlike the Ameren docket those unregulated companies are not suppliers of gas to the Companies and therefore that risk should not be considered a part of the Companies' cost of equity risk. Section 9-230 of the Illinois Public Utilities Act ("Act") (220 ILCS 5/9-230 *et seq*.), which applies "in any proceeding to establish rates or charges …" (220 ILCS 5/9-230), prohibits the Commission from including the incremental risk or increased cost of capital resulting from a utility's affiliation with unregulated or non-utility companies. (Illinois Bell Telephone Co. v. Illinois Commerce Commission, 283 Ill. App. 3d 188, 210 (1996)). Since the Companies' A- credit rating is a function of their affiliation with unregulated or non-utility companies, the cost associated with that credit rating cannot be reflected in their rates. In contrast, unregulated or non-utility affiliations do not affect the credit ratings implied by their' forward-looking financial ratios, which are calculated wholly from their revenue requirements. (Staff IB at 57-58) Staff's downward adjustment to the cost of common equity of its Utility Sample addresses the requirements of Section 9-230. In fact, the Companies agreed that an adjustment was necessary to remove the impact of non-regulated activities. (PO at 94)

Other ROEs

The Companies continue to argue that returns authorized for other utilities support its 11.06% cost of equity. (Companies BOE at 25) Staff has fully addressed this issue previously. (Staff RB at 30-31) The Companies provided no evidence to demonstrate that the facts and circumstances involved with the authorized returns they cite, including the risk level of the companies concerned, are comparable to those in the instant docket. Thus, any attempt to assess the appropriate return in this proceeding via comparison to the authorized returns the Companies cite, whether as a check or as a direct measurement, is of no value, since we have no basis on which to assess comparability. In fact, given the financial strength implied by the Companies' forecasted financial ratios, Staff would expect the Companies' required return on common equity to be considerably lower than average. Quite consistently, Staff's recommendations of 9.5% for North Shore and 9.7% for Peoples Gas fall below the 10.49% average allowed by other regulatory commissions in the U.S. for 2006 that the Companies cite. In contrast, the Companies' return request of 11.06% is above that average. (Staff RB at 30)

The Companies also assert "that evaluations and forecasts by Lehman Brothers and Value Line strongly support" their requested ROE. (Companies BOE at 25) However, the report by Lehman Brothers listed average allowed ROE for 2005, 2006, and through March of 2007 that were 10.54%, 10.45%, and 10.35%, respectively. Indeed, the average allowed return for 2007 is as close to Staff's recommendation as to the Companies recommendation. (ICC Staff Exhibit 18.0 at 14-15) Finally, the Commission rejected this type of argument in ComEd's most recent delivery services docket. (Order, Docket No. 05-0597, July 26, 2006 at153)

The Companies proposed correcting the third paragraph of Section IV.C.6. on page 89 of the Proposed Order. Staff agrees that the paragraph needs to be corrected. However, Staff does not agree with the Companies proposal. The PO combined parts of two separate arguments by Staff against the Companies proposal to look at other approved cost of equities. In order to clearly present Staff's position, Staff proposes the paragraph be revised as follows:

> Moreover, Staff contends, given the financial strength implied by the Utilities' forecasted financial ratios, it would expect the Utilities' required return on common equity to be considerably lower than average. Staff notes that given the financial strength implied by the Companies' forecasted financial ratios, Staff would expect the Companies' required return on common equity to be considerably lower than average. Quite consistently, Staff's recommendations of 9.5% for North Shore and 9.7% for Peoples Gas fall below the 10.49% average allowed by other regulatory commissions in the U.S. for 2006 that the Companies cite. In contrast, the Companies' return request of 11.06% is above that average. In fact, Staff's ~~that its~~ recommendations of 9.5% for NS and 9.7% PGL are as close to the ~~10.49%~~10.35% average allowed returns on common equity through March 2007 as reported by Lehman Brothers ~~by U.S. regulatory commissions in 2006~~ as the Utilities' return request ~~of 11.06%~~. In any event, Staff says, the Commission has rejected this type of comparability in ComEd's most recent delivery services docket. *Id*. at 30-31.

Response to CUB-City

Expected Market Risk Premium ("EMRP")

CUB-City claims that the EMRP should not be calculated by each analyst, but instead should be determined from empirical research (CUB-City BOE at 32) The PO (PO, p. 92) already considered and properly rejected those same arguments, which Staff fully addressed in its Initial Brief. (Staff IB at 67) The CAPM model requires the best available estimate of the long-term, forward-looking expectations of the specific company or companies for which the cost of equity is being measured. CUB-City has failed to show that its EMRP estimate, which is contrived from historical data presented in academic research, better reflects the current expectations for the market risk premium used by Staff. The research cited by Mr. Thomas represents various academics' opinions of the common equity risk premium investors should expect, which is not necessarily the same as what the investors truly are expecting. In fact, it is highly unlikely that investors always expect a 3-5% EMRP, since the relationship between the returns of the stock market and U.S. Treasury bonds is not stable over time. Therefore, current returns provide the best indication of what investors are expecting going forward. Hence, Ms. Kight-Garlisch's estimate of the common equity risk premium, derived by subtracting the current yield on long-term U.S. Treasury bonds from the first quarter return on the S&P 500 provides the actual difference between returns on risk-free and risky securities that exists in today's market. (Staff IB at 67)

Next, CUB-City continues to advocate against averaging the cost of equity estimates derived from the DCF and CAPM and propose greater weight be given to the DCF results. (CUB BOE at 34-35) CUB-City has failed to show that the DCF is superior to the CAPM. In addition, Staff's analysis of the ROE is consistent with past Commission practice.

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

A. Distribution of Hub Revenues[3]

IIEC, RGS and Vanguard argue in their respective BOEs that Hub revenues should not be credited to sales customers only (i.e. PGA customers). (IIEC BOE at 9; Vanguard BOE at 1-2; and RGS BOE at 32-33) However, neither the IIEC, Vanguard, nor RGS offered witness testimony to support their "proposals". The first time Staff and other parties were made aware of such a "proposal" was after the filing of the initial briefs of Vanguard and RGS (Vanguard BOE at 1) In Vanguard's initial brief, Vanguard argued that should the Commission determine that Peoples should continue to offer Hub services then all the revenues should be shared with both general service and

[3] "Distribution of Hub Revenues" is new to the outline and has been added based upon comments made by the ALJs at the December 18, 2007 Pre-Bench Session.

transportation customers. (Vanguard IB at 2) Not surprisingly, Vanguard provided no cite to the record for that position. In RGS' initial brief, RGS argued that Choices For You customers ("CFY") should receive some benefit for Hub revenues. While RGS had a cite to the record, the cite RGS provided was to a page from the transcript where Company witness Zack stated that "[s]ince the fiscal 01 Gas Charge reconciliation case and settlement, all the gross revenues from the Hub have gone to a credit to the gas charge …" (September 11, 2007 Transcript, Tr. at 642)

Staff has some concerns with the merits of the proposals, but rather than enumerate these concerns at an inappropriately late stage of the case, as these other parties have done, we note only that the parties are free to bring up their proposals in future proceedings where they can be fully litigated.

Vanguard takes issue with the PO for not addressing its Hub revenue issue (Vanguard BOE, p. 1) and IIEC and RGS argue that the PO should be modified to provide a flow through of the Hub revenues to other customers beside sales customers (RGS BOE, pp. 32-33; IIEC BOE at 9) Despite the fact that Staff and Peoples Gas offered numerous pages of witness testimony on Hub related issues, IIEC, Vanguard and RGS never raised this issue in their own witnesses testimony. Despite the fact that the Commission's order which ordered Hub revenues to flow through the PGA was issued in March of 2006, a year before Peoples Gas filed its proposed tariffs, IIEC, Vanguard and RGS failed to offer testimony on the Hub revenue issue in the instant docket. For Vanguard to take exception to the PO for not addressing the issue is simply without merit. Their proposal was never appropriately at issue in the docket. As mentioned previously, two of the parties simply raised it in their initial briefs (Vanguard BOE at 1) without any record evidence on the issue.

The issue of flowing Hub revenues in a manner other than as required by the Commission's order in Docket No. 01-0707 simply has not been raised at an appropriate point in this docket with evidence, and Staff would caution the Commission against addressing the issue at such a late stage of this proceeding. The Commission should consider the following: (1) no party, including Staff, has had an opportunity to offer testimony on the IIEC's position that the Hub revenues should be spread between all customers on a therm delivered basis (IIEC BOE at 9); (2) no party, including Staff, has had an opportunity to respond to RGS's position that the Hub revenues should flow through to sales customers and CFY customers only (RGS BOE at 33); (3) no party, including Staff, has had an opportunity to respond to Vanguard's position that Hub revenues should be credited to all customers, including transportation and [CFY] customers (Vanguard BOE at 2); and (4) no party, including Staff, has had an opportunity to offer evidence addressing whether the proposal is even consistent with the Commission's own PGA rules (Part 525, Purchased Gas Adjustment Clause).
Given all of the above, the Commission should reject the IIEC's, Vanguard's and RGS's exceptions on this issue. To the extent the parties believe the issue needs to be addressed, they are free to raise it in future proceedings where it can be appropriately and fully litigated.

VII. NEW RIDERS

A. Overview

The Utilities contend that the Proposed Order improperly rejects Riders VBA, WNA and ICR.[4] To the contrary, the Proposed Order properly rejected proposed Riders VBA, WNA and ICR, finding, *inter alia*, that: ; (1) regardless of whether the Commission has the discretionary legal authority to approve Rider VBA, exercise of such discretionary authority is neither reasonable nor appropriate given the failure of the Utilities to address or propose safeguards to protect ratepayers (PO. at 132-133); (3) as with Rider VBA, exercise of the Commission's discretionary authority to approve riders is not warranted for Rider WNA given the state of the record regarding the benefits and pitfalls of implementing this novel proposal (*Id*. at 140); (3) Rider ICR contravenes the prohibition against single-issue rate making by providing for a recovery of and on additional capital expenditures in isolation and in disregard of offsetting savings (PO at 146-147); (4) the evidence in the instant docket establishes that the capital costs to be recovered through Rider ICR are not the type of unexpected, volatile, or fluctuating costs that would justify rider recovery (*Id*. at 147-148); (5) it is uncontested that neither safety nor reliability are part of the supporting rationale for Rider ICR (*Id*. at 149); and (6) to the extent the Commission does have the discretionary authority to approve Rider ICR, exercise of the Commission's discretionary authority to allow rider recovery is not warranted because of the same issues, concerns and deficiencies that support the rejection of Rider ICR on legal grounds (*Id.*).

[4] The Utilities did not file Exceptions to the Proposed Order's rejection of their proposals to recover commodity-related uncollectibles expense through Rider UBA.

Moreover, as was fully explained in Staff's post-hearing briefs (Staff IB at 162-202; Staff RB at 47-79), Riders VBA, WNA and ICR suffer from many other legal and factual shortcomings, have not been shown to be reasonable, necessary or beneficial to ratepayers, and have not been shown to produce just and reasonable rates. As was amply demonstrated by Staff and Interveners, the instant proposals contravene the prohibitions against retroactive and single-issue ratemaking, as well as the Commission's test year rules. Unlike other riders that have been approved by the Commission and upheld by the Courts, Riders VBA, WNA and ICR do not "merely facilitate[] direct recovery of a particular cost, without direct impact on the utility's rate of return …." (*Citizens Util. Bd. v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 138 (1995)) Instead, Riders VBA and WNA guarantee recovery of revenue, and Rider ICR guarantees recovery of a return on new investments made between rate cases. By guaranteeing the recovery of revenue (i.e., the revenue requirement used to establish rates), Riders VBA and WNA ensure recovery of the rate of return on rate base included in the revenue requirement and, therefore, do impact the return earned by the Utilities.

The Commission should deny the Utilities' request for approval of Riders VBA, WNA and ICR, consistent with the ultimate conclusions reached in the Proposed Order.

1. Rider VBA

The Utilities assert that "a decoupling rider is no more illegal in Illinois than it is in the numerous states that have approved similar riders." (Companies BOE at 42) While such an assertion does little to address the merits of the instant proposal on a substantive basis, and represents an unfortunate distraction from the real issues, Staff is compelled to respond since this is the argument the Utilities have made. This assertion lacks both substance and merit. As Staff has previously explained in its post-hearing briefs, the number of states that have decided to allow some form of decoupling is not as extensive as the Companies' suggest. (Staff IB at 165, 176-181; Staff RB at 56-57) Further, the Companies have not presented any discussion, analysis or argument indicating that the limited regulatory decisions upon which they rely engaged in any analysis of legal issues that would be instructive in the instant case. Nor have they argued or demonstrated that the regulatory bodies in those states operate under legal and statutory constraints similar to those applicable to the Commission. Consequently, an assertion that other states have allowed some form of decoupling rider is no indication whatsoever that a decoupling rider is proper under Illinois law. The Utilities' specific decoupling proposal must pass scrutiny under Illinois law, and whether decoupling riders are legal under the laws of other states is not determinative of whether decoupling riders are allowable under Illinois law.

Moreover, somewhat more telling is the fact that the Utilities have not cited to a single case indicating that any of the public utility commission decisions they rely upon have been subject to or withstood judicial review. This is not surprising since, as Staff pointed out in its Reply Brief, many of the other public utility commission decisions upon which the Utilities rely involved some form of "settlement" or "stipulation" that was accepted by the regulatory body with various limitations and restrictions instead of a decision on the merits. (Staff RB at 54-60; *see also* PO at 132) While the court in *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607 (1958) *("City I")* did note, as an aside or *dicta*, that other states had adopted riders for the recovery of purchased gas (Companies BOE at 49), what the court found relevant for purposes of its decision was the single instance in which there had been a judicial review of such decisions and further that such review involved statutory language virtually identical to the statutory language at issue before the court. (Staff IB at 128-129) No judicial consideration of decoupling decisions has been offered in the instant case, further evidencing the irrelevancy of the Utilities' extensive reliance on matters occurring in other states with respect to the Illinois specific issues presented here.

Staff further notes that since the filing of its Initial and Reply Bbriefs, more states have rejected decoupling mechanisms. (In re UNS Gas, Arizona Corporation Commission, 2007 Ariz PUC LEXIS 241, Order dated Nov. 27, 2007, pp. 33-37) In addition, Arkansas adopted a Staff alternative decoupling mechanism through a settlement agreement that stipulated a ten basis point reduction to the utilities ROE if a decoupling mechanism were to be implemented. (In re Arkansas-Oklahoma Gas, Arkansas Public Service Commission, Docket No. 07-026-U; 2007 Ark. PUC LEXIS 438, November 20, 2007, p. 7)

The Utilities assert that "the Proposed Order finds that Rider VBA is not the type of mechanism that the Commission has authority to adopt because Rider VBA is 'fundamentally different' from any other rider that has been authorized in Illinois." (Companies BOE at 42) While the Proposed Order does indicate that Rider VBA is fundamentally different from other riders that have been authorized, it does not include the finding regarding authority asserted in the Utilities' BOE. The Utilities explicitly acknowledge in an attendant footnote that the Proposed Order did not reach any legal conclusions with respect to Rider VBA. The Utilities' acknowledged mischaracterization of the Proposed Order's legal rulings regarding Rider VBA is pointless, and should not be allowed to confuse the issues. The Utilities attack the Proposed Order's discussion of the reasons for declining to allow rider recovery (Companies BOE at 43), but they never acknowledge that these reasons constitute the basis for declining to exercise the Commission's discretionary authority to allow rider recovery. As such, the analysis is unavailing. Further, the Utilities improperly attempt, after the close of the evidentiary record and at the 11th hour, to propose changes to their rider proposal with new conditions to address the problems and issues with Rider VBA. (*Id*. at 43, 50-51) These new proposals were not made by any witness, were not provided within the context of the testimonial schedule, and were not provided in any manner that would allow Staff and other witnesses to respond. These new proposals are not properly made and, to the extent that they were considered, are simply too little too late. The legal deficiencies pointed out by Staff and Interveners, as well as the lack of adequate justification for Rider VBA, are not remedied in any way by implementing Rider VBA with newly proposed conditions or safeguards.

The PO correctly noted that there has been no "discussion" of these safeguards, and the Utilities have therefore insufficiently presented Rider VBA. (PO at 132) Attaching safeguards without any discussion or analysis as to their impact and actual result on rates is premature and short sighted. Staff cannot present the Commission at this stage in the proceeding with any analysis of the abstract ideas presented by the Companies in their Brief on Eexceptions. Safeguard are not, by definition, haphazardly applied. For a safeguard to accomplish its purpose, safely guard the ratepayers, Staff and Interveners must investigate the parameters and scope of the proposed safeguards, while thoroughly analyzing what has worked in other states and why. This proceeding can no longer produce such results, and any decision to apply ad hoc safeguards at this juncture will be untested and dangerous. Staff strongly urges the Commission to reject Rider VBA.

Further, These proposals envision a requirement that the Companies be required to rejustify the riders in the next rate proceeding. That way, Peoples Gas and North Shore argue, the Commission will have a concrete experience in Illinois on which to base future revenue decoupling decisions, rather than having to study the results from other states. (Companies BOE at 50) This proposal is problematic in three respects.

First, there is no evidence or discussion on the record concerning the offering of the proposed rider on a pilot or limited term basis. The Companies proposed their riders as permanent additions to the regulatory process. No evidence has been presented to demonstrate that these alternative formulations will provide meaningful protections to ratepayers from potential adverse consequences. Second, the assumption behind these alternatives is that the Companies would be able to implement the proposed riders at least until their next rate filings. This could expose ratepayers to adverse consequences for a considerable period of time. It should be remembered that Peoples Gas and North Shore did not file a rate case for a full twelve years before this case. If the interval to the Companies' next rate case is similarly long, ratepayers could face long term consequences from these riders despite their pilot or limited term designation. Third, there is considerable downside risk for Peoples Gas and North Shore ratepayers so as to have this rider in exchange for giving Illinois a concrete experience on which to base future decoupling decisions. There is an advantage for others to go forward first. For example, when California deregulated its electricity market and created an alternative structure, Illinois did not blindly follow and was able to avoid serious problems that California had to grapple with as a result. That experience alone demonstrates the potential dangers of deviating from the traditional regulatory paradigm.

The Utilities' argue that the decision in *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317 (1st Dist. 1993) is not instructive here. (Companies BOE at 43-44) The Utilities contend that "the *Finkl* Court did not seem concerned at all that Rider 22 involved lost revenues . . . ." (*Id*. at 44) To the contrary, the *Finkl* court noted that the lost revenue feature of Rider 22 failed to "take into consideration Edison's aggregate costs and revenues." (*Id*.) The court held that requiring ratepayers to bear the expense of services they avoid due to conservation or DSM programs "runs afoul of basic ratemaking principles …." (*Id*. at 329) Rider VBA similarly allows to take into account the Utilities' aggregate costs and revenues at the time of subsequent rate increases under Rider VBA. The Utilities' assertion that the *Finkl* court expressed no concern over lost revenues is simply wrong.

The Utilities also argue that their proposed decoupling rider is appropriate under *City I*. (Companies BOE at 44-47) The Companies argue that "[t]the City I Court did not articulate any restriction on the Commission's power to adopt automatic rate adjustment provisions and acknowledged that the General Assembly recognized the need for the Commission to have broad authority in setting rates that adjust in the future …." (*Id*. at 44) This is not accurate. The Court specifically noted that the authority to allow rider recovery was not unlimited, but rather was allowable "in the proper case." (*City I, 13 Ill. 2d* at 614) Further, the discussion of the Commission's authority at page 611 of *City I* concerns the issue of fixed versus formula rates, and not whether riders are appropriate for all aspects of the revenue formula.

The Companies assert that "[n]either *City I* nor any subsequent case involving riders has placed any restriction on the Commission's discretion to approve riders because a rider might involve the recovery of revenues, as opposed to costs or expenses." (Companies BOE at 45) Besides the holding in *Finkl* discussed above, Staff is not aware of any Illinois case explicitly ruling that rider recovery of revenues is permitted or prohibited. The issue has simply not been considered by any court because there has not been a rider, until now, that explicitly seeks to recover revenues. But the lack of an explicit ruling does not mean that riders to recover revenues cannot be judged against the standards that Illinois courts have considered. There is no question that a rider to guarantee revenues is far afield from the targeted treatment of specific costs that have been authorized and upheld by the courts. Moreover, as explained herein and in Staff's post-hearing briefs, a rider mechanism to ensures revenues for costs otherwise approved for base rate recovery is contrary to the rule against retroactive ratemaking, and inappropriate on that ground. Thus, the Utilities argument that there is no legal basis for rejecting Rider VBA is completely lacking in merit, and contains no substantive analysis of the legal issues clearly presented by Staff and Interveners.

The Utilities also argue that Rider VBA is proper because *City I* authorized formula rates and Rider VBA contains a formula. (Companies BOE at 45-46 ("where an adjustment mechanism is a rate schedule approved by the Commission which contains a mathematical formula for making future changes in the rate schedule, it is not unlawful under the Act.”)) The Companies’ argument statement is completely illogical, and ignores the fact that the rider struck down in *Finkl* was also a formula rate. Staff has not argued that Rider VBA is improper because it contains a formula rate, and that subject is simply not an issue in this proceeding.

The Utilities also characterize the Proposed Order as establishing what it calls a “preferable techniques” test. (Companies BOE at 46-47) Not only does this mischaracterize the Proposed Order, but is involves a discussion in the Proposed Order of Rider ICR rather than Rider VBA. The Proposed Order simply makes a correct observation that the factual circumstances presented in *City I* are different than the factual circumstances surrounding the proposal under Rider ICR. The Proposed Order did not state that it was establishing a test. Staff’s reading of this portion of the Proposed Order is that the absence of a preferable technique constitutes one of the factors which form the basis for declining to exercise the Commission’s discretionary authority to approve rider recovery under Rider ICR.

The Utilities contend that the Proposed Order improperly focuses on whether a utility could avoid or control a cost in considering the whether riders are appropriate for costs that are unexpected, volatile or fluctuating expense standard. (Companies BOE at 52) Staff notes that this analysis in the Proposed Order occurred with respect to Rider ICR. More importantly, Staff observes that it was the Utilities themselves that argued that the focus of *Finkl* was on the controllability of costs. (Companies Reply Brief at 87-88). No explanation is given for this change in interpretation, and no reasonable explanation can be given. The Proposed Order correctly observes that the ability to avoid or control costs is a key factor in determining whether rider recovery of particular costs is appropriate.

Peoples Gas and North Shore also complain that the PO does not consider the impact from the implementation of energy efficiency programs. (Companies BOE at 51) This complaint is unjustified. Rrecent experience demonstrates that Peoples Gas and North Shore can be successful even when ratepayers are taking active steps to conserve. Not only were the two Companies able to forego filing for a rate increase for the last 12 years, they demonstrated an ability to meet or exceed their authorized rates of returns for several of these years. For example, Peoples Gas and North Shore met or exceeded its approved rate of return seven out of eight years from 1996 until 2003. Over that same period, North Shore exceeded its authorized return six out of eight years and as late as 2003 earned a return of 14.13%. This consistent financial success undermines the Companies' claim that the traditional regulatory paradigm is broken and needs to be fixed. (ICC Staff Ex.8.0, p. 6, lines 118-133)

The Companies downplay the impact of Rider VBA on their ratepayers, dismissing it as "merely a policy decision to employ a new rate design approach". (Companies BOE at 53) This characterization is incorrect. Rate design is a revenue neutral discipline. The proposed riders are not. They will adjust the level of base revenues collected from ratepayers each month with no guarantees that the swings will even out.

While making numerous assertions that Rider VBA is within the Commission's legal authority to authorize, the Utilities nowhere discuss the prohibition against retroactive ratemaking issues addressed by Staff and Interveners. The prohibition against retroactive ratemaking applies to rates established by the Commission. As explained in Staff's Initial Brief, the rate setting process in Illinois has two major components: (1) development of a utility's revenue requirement and (2) development of specific rates designed to permit a utility to recover its revenue requirement, or the rate design process. (Staff IB at 125-127) The prohibition against retroactive ratemaking proscribes the retroactive adjustment of rates previously established. The basis for that adjustment, whether to implement modifications of revenue requirement determinations or rate design determinations, is irrelevant. All Commission rate determinations operate prospectively. By providing for surcharges or refunds when base rates produce revenues that vary from the per person revenue requirement such rates were designed to recover, Rider VBA engages in exactly the type of retroactive adjustment of rates previously determined that is prohibited under Illinois law.

2. Rider WNA

As noted above, while Rider WNA is limited to impacts on revenue driven by weather, it operates in all other material respects very similarly to Rider VBA. The differences between Rider WNA and Rider VBA do not compel or require a different result. As was the case with Rider VBA, the fact that Rider WNA contains a formula does not establish it is an appropriate rider. In addition to the legal issues addressed in Staff's post-hearing briefs and Exceptions, Rider WNA suffers from the same inadequate support as Rider VBA. The Utilities have not demonstrated any compelling need for Rider WNA, as explained in Staff's prior filings.

The Companies begin their discussion by stating that Rider WNA is "more narrowly focused" than the proposed Rider VBA. (Companies BOE at 54) The implication is that this feature would make Rider WNA more palatable than Rider VBA. However, the Companies fail to explain why that would be so.

The Utilities argue that Rider WNA is justified by the fact "that the Utilities have not been able to recover approved margin revenues over the past 9 years." (Companies BOE at 54) The Companies state that their margin revenues have clearly been impacted by weather and customer usage and it would be "unreasonable and arbitrary" to deny them any relief. (*Id*. at 54-55) These claims are erroneous. Company witness Feingold admits that the Commission has never used the term "margin revenues" in a previous rate order. (Tr. 1372, lines 17-22) Thus, there never has been an approved level of margin revenues that the Utilities have failed to meet. In addition, the evidence is clear that they enjoyed many years of financial success since their last rate case based on their rate of return which is the key measure the Commission employs for assessing the financial health of utilities.

The Companies contend that Rider WNA "does not constitute single issue ratemaking" because it "does not involve the impact of any set of costs and expenses on the revenue requirement or rate of return". (Companies BOE at 56) This claim is wrong. The proposed rider could adjust revenues independently of the return being earned by Peoples Gas and North Shore. If the Companies are already earning their authorized returns, Rider WNA could provide them a windfall. The fact remains that Rider WNA adjusts rates previously established, and does so without considering whether other components of the revenue requirement formula have changed at the time of adjustment.

As with Rider VBA, the Utilities argue that weather normalization riders are utilized in other states. (Companies BOE at 55) This argument is unconvincing for the same reason asserted with respect to Rider VBA. Staff would add, however, that some of this experience is negative. In June 2005, the Connecticut legislature enacted legislation mandating its public utility commission to investigate decoupling mechanisms such as weather normalization mechanisms. (Connecticut Public Act 05-01, Section 21) The Connecticut Department of Public Utility Control ("DPUC") entered its findings on decoupling in its state and others in January of 2006. (DPUC Investigation into Decoupling Energy Distribution Company Earnings from Sales; Connecticut Department of Public Utility Control, Docket No. 05-09-09, 2006 Conn. PUC LEXIS 91; 247 P.U.R.4th 387,January 18, 2006) The DPUC investigated a weather normalization adjustment rider that had been in place since 1994. (Id. at 14-15) The rider was a "symmetrical" rider that gave credits or adjustment based on variances from normal weather (Id.) In its investigation, the DPUC was alarmed to find that in the 11 years that the rider was in place, the ratepayers only received $6.7 million in credits, while ratepayer bills where adjusted in favor of the utility by $34.3 million. The DPUC considered these results overly "skewed" in favor of the utility, and will be investigating the WNA rider further. (Id.) Results such as these corroborate Staff's analysis reflecting that the Companies' proposed riders would be costly to Illinois ratepayers.

B. Rider ICR

Peoples Gas notes a general exception to the PO's rejection of Rider ICR. More specifically, Peoples Gas contests at least eight issues with respect to the PO's rejection of Rider ICR. Staff supports the PO's conclusions, and finds Peoples Gas' arguments flawed and unpersuasive.

First, Peoples Gas attempts to convince the Commission that City I's approval of rider recovery of costs is without restrictions. (Companies BOE at 59-60) This is an effort to persuade the Commission that the PO's argument of a "preferable technique" test is inappropriate. However, the Company misunderstands the PO's discussion of City I. It is the PO's argument that while City I acknowledged the Commission's broad discretion to adopt riders as a "'pragmatic' ratemaking power," it is still discretionary, and discretions can be abused. (PO at 144) Thus, the PO notes that the court in City I found the Commission properly applied rider recovery to the facts of the case, because historically, gas charges have warranted unconventional ratemaking procedures. (Id. at 145) Prior to City I, the Commission apparently allowed for gas charge rate increases filed with the Commission to go into effect without being suspended. (Id.) Thus, transitioning to a rider for the same recovery only made sense. Moreover, in the coal tar cases the Supreme Court's ruling explicitly held that rider recovery is an option, and could be the preferred option, if the evidence warrants it. (Citizens Utility Board v. Illinois Commerce Commission, 166 Ill.2d 111, 140 "[A]pproval of a rider as the *preferred* mechanism for recovery of coal-tar cleanup costs is within the Commission's authority and not against the manifest weight of the *evidence*." (*emphasis added*)) Thus City I and CUB together support the position that riders, as a discretionary measure, must be based on the evidence and should be the Commission's logical and, therefore, preferred option in recovery of the costs in question. If not, discretionary rejection of a rider proposal would be appropriate.

Conversely, infrastructure costs, like the ones to be recovered by Rider ICR, have almost always been handled under traditional rate making procedures. Exceptions have only occurred when the legislature has mandated another means of recovery. (Discussed *Infra*.) To deviate now would warrant a special finding that there is reason to abort the traditional method of recovering infrastructure costs. The record does not support such a finding, nor does an historical analysis of infrastructure cost recovery. Therefore, Peoples Gas is incorrect in assuming that the court's discussion of "preferable techniques" in City I is dicta, when in fact it goes to the heart of rider recovery. While the Commission has broad discretion to implement a rider to recover costs, it is not unfettered discretion, and the court in City I simply reasoned that in that instance, it followed to have gas charges pass through a rider when the tariffs controlling them where being passed through without suspension. (13 Ill.2d at 618)

Secondly, Peoples Gas argues that the associated costs of a main CI/DI replacement program deserve rider treatment because of their uncertain, unpredictable, and fluctuating nature. According to Peoples Gas, the unexpected opportunities for main replacement cannot be predicted and therefore deserve recovery through a rider mechanism. (Companies BOE at 62) Staff has demonstrated the fallacy of this argument, which the PO has correctly adopted. The costs associated with a main replacement program are solely controlled by Company. At no point will the Company be forced to accelerate its program. At no point will the Company be forced to not take advantage of construction or development opportunities that may afford it some cost savings in replacing its mains. The Company can, at its discretion, speed, slow, or stall its main replacement program so long as safety and reliability are not an issue. And, as the record indicates, safety and reliability are not the reasons for implementation of Rider ICR. (NS/PGL Reply Brief at 110)

The Company attempts to mislead the Commission by arguing that the costs are controlled by third parties. (Companies BOE at 61) That is incorrect. At best, the costs may be influenced or affected by third parties, but no more so than any other costs. For example company executives may ask for a raise, but the company's payroll is not therefore at the whim of its employees. The company can give that executive a raise, or it can wait, or fire that employee and hire a less experienced cheaper substitute. More specifically, Rider ICR and the main replacement program do not relinquish Peoples' check book to the city of Chicago or developers, nor do they hold Peoples hostage to certain costs that it is now able to avoid. Rider ICR allows the Company's shareholders to not experience a loss in-between rate cases with regard to infrastructure repair, thereby allowing the Company to increase its replacement of CI/DI mains. Since well before the merger, approximately 1991, Peoples Gas has been able to conduct a main replacement program without the need of a rider, thus demonstrating that it is possible to plan and budget for a main replacement program and not be at the whim of the city of Chicago and the ambiguous developers.

Third, the Company does not take exception to the PO's conclusion that Rider ICR violates the proscription against single issue ratemaking, instead it proposes measures to ameliorate this concern. First, Peoples Gas acknowledges that the program will produce annual leak repair savings of $180,000-$300,000. (Companies BOE at 63) However, Staff first notes that under the rider as originally proposed, these savings would go to shareholders and not ratepayers, and thereby counteract the need for additional revenues to implement the main replacement program. Only in the Company's BOE version of the rider does Peoples contemplate sharing those cost savings with customers.

Peoples Gas next points to program modifications that will limit the potential revenue impact of the proposed Rider ICR, again to only mitigate the single issue ratemaking issue, not eliminate it. (Companies BOE at 63) However, the case law is clear: a rider cannot violate the proscription against single-issue ratemaking. (Finkl, 250 Ill.App.3d at 326) A minor single issue ratemaking infraction is not acceptable, either the rider violates the rule or it does not. Peoples Gas is attempting to create a gray area for Rider ICR to exist.

In a bold attempt, the Company proposes to modify Rider ICR so that leak repair savings and reductions in deferred taxes resulting from the main replacement program offset the costs of the program. (Companies BOE at 63) It is simply not possible to accord any reasonable review to this new proposal offered in the Company's Brief on Exceptions. All the information necessary to make this proposal was available to the Company at the beginning of the proceeding. Yet, Peoples Gas chose to wait until the record was closed, and the PO ruled against Rider ICR. Moreover, the Company has, through its new proposal, acknowledged that Rider ICR violates the proscription against single-issue ratemaking, the solution is not to lessen the magnitude single-issue ratemaking is violated, but to eliminate the rider all together. Changing the rider with a proposal that may or may not offset all involved costs does not guarantee that no other costs or saving will be affected. Thus, the single-issue ratemaking problem is still inherent in the rider, and the rider must be rejeted.

Fourth, the Company repeats the claim made for Rider VBA that Rider ICR "is merely a policy decision to employ a new rate design approach" (Companies BOE at 64) Again, the contention is erroneous. Rider ICR is designed to generate additional revenues for the Company while rate design seeks to recover revenue levels previously set.

Fifth, the Company argues that the Commission does not need a mandate from the general assembly to approve Rider ICR. The PO and Staff disagree with the Company. The PO states that the legislature has essentially pre-empted the Commission's authority in this regard, because the legislature has delegated a specific instance where infrastructure costs can be recovered through a rider. (PO at 147) The legislature did not pass a general or generic rule where all infrastructure costs can be recovered through a rider, instead it passed a very specific rule that in essence occupied the field and reserved that right only for itself. The Company again attempts to simplify the case law and misrepresents City I as holding that the Commission's authority is broad enough to overcome legislative preemption. Without specifically addressing the matter, the Company does not persuade Staff that the legislature's intent was other than what the PO discusses on page 147.

Sixth, the Company argues that the Peoples Gas system is unique, but does not explain why this is a reason for rider recovery of infrastructure costs. The Company is not implying that there is a safety or reliability issue, the Company confusingly states that because of the density of its system and the age of its mains, it differs from all other Illinois gas utilities, implying that special treatment in the form of higher revenues through rider recovery of its infrastructure costs is necessary. (Companies BOE at 65)

Staff does not follow the Company's logic. The gas mains in Chicago are dense and old because they are gas mains in Chicago, a densely populated old city. Chicago is unique because it is the only major metropolitan city in Illinois. Therefore, is the Company insisting that Chicago, being *so* unique, must be treated differently, if so, would it be different in California where there are more than one major metropolitan city? Moreover, does Rider ICR attempt to preserve Chicago because we are in danger of losing it, thus leaving Illinois with no major metropolitan city?

Moreover, the decision of when and how to replace distribution mains is a business decision made by utility executives. If Peoples Gas chooses to leave older mains in the ground that do not pose a safety or reliability problem, that is their decision. Other utilities may choose a different replacement plan. Nevertheless, ratepayers have no part in this decision-making process, and now if the Company chooses to accelerate the replacement process, ratepayers should not be penalized for this change in business strategy. They should not have to pay the additional cost of Rider ICR for the Company's unsupported urgency to modernize its system.

Seventh, Peoples Gas also trumpets the fact that the City of Chicago supports the proposed Rider ICR. (Companies BOE at 66) The Company goes on to note that the City supports this "significant effort to bolster and improve this critical aspect of the City of Chicago's infrastructure". (Companies BOE at 66) Staff does not take issue with the Company's efforts to improve its infrastructure. The issue is whether ratepayers should have to pay an additional penalty to enjoy an already safe and reliable system. Staff believes they should not.

Lastly, Peoples Gas returns to the theme of uncertainty, once again arguing that the Company will not have the benefit of knowing when the opportunities to modernize its system will arise. (Companies BOE at 67) As Staff has noted, the need to coordinate with the City is nothing new, and Peoples Gas is not at the whim of the City and can accelerate or decelerate its program as it sees fit. Peoples is free to choose when and where it will spend its money, and if it anticipates that events such as the Olympics will afford it multiple cost saving opportunities, the Company can, as the PO points out, take advantage by requesting a base rate adjustment when such opportunities are imminent and not so abstract. (PO at 148)

In sum, the Company's arguments for its proposed Rider ICR continue to suffer from several fundamental flaws, all highlighted by the Proposed Order. First, Rider ICR violates the proscription against single-issue ratemaking. Second, and only if the first obstacle were overcome, the Commission would still be without reason to implement an infrastructure cost recovery rider because it is an unusual treatment for such a cost, and could be an abuse of discretion. Lastly, the costs associated with Rider ICR are solely within the control of the Company, more than any costs discussed in any of the seminal rider cases. The PO is correct in rejecting Rider ICR, and Staff urges the Commission to adopt the PO's conclusions.

E. Deferred Accounting Alternative to Certain Rider Requests

The Utilities argue that the Commission should allow deferral of revenues as an alternative to Riders VBA and ICR. (Companies BOE at 69-71) Staff fully explained why deferred accounting alternatives would be inappropriate in its post-hearing briefs (Staff IB at 221-226), and specifically explained why revenues must be treated the same as expenses for purposes of deferred accounting. (*Id*. at 223-224) The Utilities now appear to argue (contrary to their argument that these riders have no impact on earnings) that the revenues recovered through Rider VBA and WNA would include a return on its assets. (Companies BOE at 69) It is true that utility revenues include recovery of a return on rate base, but that does not transform revenue into a financing or capital cost in and of itself. Staff's analysis of the *BPI II* opinion in its Initial Brief is more appropriate, and demonstrates that revenues are akin to expenses in terms of considering requests for deferred accounting.

Similarly, the Utilities' arguments with respect to "matching" misses the mark. The matching discussed in BPI II with respect to deferred expenses is the matching of revenues and costs within a rate case, not the matching of rate case assumptions or projections with post-rate case developments. Similarly, normalization is simply not an issue and billing determinants have been determined based on adjustments for normal weather.

For all these reasons, the Utilities exceptions should be denied.

VIII. COST OF SERVICE

B. Embedded Cost of Service Study

2. Contested Issues

a. Coincident Peak Versus Average and Peak Allocation Methods

The Companies continue to urge the Commission to reverse its long-held conclusion that natural gas distribution system costs should be allocated according to a combination of Average load and Coincident Peak demand ("A&P"). (Companies BOE at 71-75) Instead, the Companies argue that Coincident Peak demand ("CP") is the only factor that should be considered in allocating those costs. The Commission should reject the Companies' argument, and affirm the PO's conclusion that gas distribution system costs should be allocated according to A&P.

The Companies back their argument by observing that the distribution system is sized to accommodate peak day demand. (Id. at 74) This argument supports the concept that peak day demand should be considered in allocating distribution system costs, but it does not support the concept that increases in natural gas distribution system costs have a direct, dollar-for-dollar relationship with increases in peak demand and is therefore the only consideration in the allocation of those costs. The Companies' own cost of service witness developed a cost equation to depict the relationship between distribution system costs that do not vary with demand and distribution system costs that vary with demand. (North Shore Ex. RJA Ex. 1.0 at 25-26, lines 551-566; and PGL Ex. RJA Ex. 1.0 at 25, lines 547-562) Similar to the cost equation developed by the Companies' witness, an A&P allocation recognizes the effect that increases in installed capacity have on distribution system costs, but also recognizes the fact that a portion of distribution system costs are caused by the mere fact that a distribution system is installed and are not, therefore, affected by increases in capacity. The effect of an A&P allocation is to make an allowance for costs that do not vary with increases in installed capacity, and then allocate those costs to those customers who, day-to-day, use the distribution system the most. The problem with a CP allocation is that it makes no allowance for the use of the system day-in and day-out and considers only differences in peak day demand in the allocation of costs, even though some costs, as previously stated, are not affected by differences in installed capacity to meet higher demand. In the instant dockets, as well as in natural gas company rate dockets over the past 13 years, an A&P allocation has been consistently demonstrated to be a superior method of allocating distribution system costs compared to a CP allocation because A&P makes the dual recognition that some, but not all, distribution system costs increase with the installation of more capacity.

The Commission should also ignore the Companies' argument that A&P has not been approved as an allocation factor in electric distribution rate dockets. (Companies BOE, pp. 73-74) In comparing the use of A&P with natural gas utilities and the use of A&P with electric utilities, the Companies mention that non-coincident peak demand ("NCP") has been used to allocate electric distribution system costs. The use of NCP in allocating electric distribution system costs is an indication that the Commission has recognized that there are differences in the operation of electric distribution systems compared to natural gas distribution systems because NCP is more applicable to electric utility cost of service and is not under consideration in the instant natural gas distribution company dockets. Furthermore, as the Companies recognize, the Commission is open to review of A&P in the allocation of electric distribution system costs because there are similaritiesbetween the electric and natural gas distribution businesses, but there are also differences. In the instant dockets, the Companies' comparison of similarities, and the differences, between the electric and natural gas distribution industries in its BOE is outweighed by the clear demonstration that some natural gas distribution costs are not affected by increases in installed capacity.. For the same reasons as stated in the PO, the Commission should re-affirm its consistent conclusion over the past 13 years that natural gas distribution costs are better allocated according to A&P instead of CP.

b. Classification of Uncollectible Account Expenses Account No. 904

The Companies continue to maintain that uncollectible accounts are a customer cost, rather than a blend of uncollected customer charge and usage charge revenues. (Companies BOE at 75-77) As the PO properly recognizes, uncollected revenues from uncollectible accounts are a combination of unpaid customers charges, unpaid usage charges, and unpaid gas costs. For example, if two customers do not pay their bills, and one customer has higher usage than the other customer, the customer with higher usage represents a greater addition to uncollectible accounts expense than the customer with lower usage because higher usage translates to higher usage charges, higher gas costs, and hence, higher unpaid bills. (Staff Reply Brief at 94) Clearly, uncollectible accounts expense is a function of the underlying charges that comprise the unpaid accounts. Since customer costs are generally recovered through the customer charge, unpaid customer charges should be considered a customer cost recovered through the customer charge. Since distribution and demand costs are recovered through the distribution charge, unpaid usage charges should be considered a distribution and demand cost recovered through the distribution charge. Since the amount a customer is billed for gas costs varies through the Rider 2 charge that is based upon usage, uncollectible gas costs should be recovered through the distribution charge. Therefore, apportioning uncollectible accounts expense according to the relative weights of customer costs, demand and distribution costs, and gas costs within a given customer service classification is a reasonable approach to spreading uncollectible accounts expense across the charges included in a bill that goes unpaid.

The Companies would consider uncollectible accounts expense solely a customer cost recovered through the customer charge. (Companies BOE at 77) Under that approach, all customers within a customer service classification would pay the same amount for uncollectible accounts expense because all customers within that customer service classification pay the same customer charge. The proportion of uncollectible accounts expense included in a bill to a customer who is billed a higher amount for higher usage would then be lower than a customer who is billed less for lower usage. For example, if $1.00 was part of the customer charge to all customers in order to recover all uncollectible accounts expense, then uncollectible accounts expense would represent five percent of a $20.00 bill, but only two percent of a $50.00 bill to a customer who had more natural gas delivered. By concluding that uncollectible accounts expense should be considered a blend of unpaid customer charge revenues, distribution charge revenues, and gas cost charge revenues, the PO correctly recognizes that to be an unreasonable result.

The Companies complain that an allocation of uncollectible accounts expense across customer costs, distribution and demand costs, and gas costs is a redundant allocation of the same costs to the customer classes. In a sense, the Companies are correct that uncollectible accounts expense is redundant because it is an expense that would not exist if all bills and, by extension, all elements of all bills were paid. The concept that uncollectible accounts expense is a redundant expense does not mean that uncollectible accounts expense should be classified on a different basis than the costs included in the bills that underlie uncollectible accounts. Since some bills go unpaid, it is appropriate to re-allocate each rate element of unpaid bills by including a provision for uncollectible accounts expense in each cost classification, which results in a provision for uncollectible accounts expense in each rate element of a customer's bill. The Commission should leave intact the PO's proper conclusion that the amount of uncollectible accounts expense allocated to each customer service classification should be classified according to the relative weight of customer, demand, distribution, and gas costs within the corresponding customer class.

IX. RATE DESIGN

2. Contested Issues

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

The Companies argue in their BOE that "The Proposed Order also correctly concluded that 'the Utilities' proposals represent the most reasoned approach to establishing just and reasonable rates for small residential heating and non-heating customers.'" (Companies BOE at 82) Staff disagrees with the Companies and accordingly, Staff took exception to the PO on this issue. (Staff BOE at 82-85) To further support Staff's position on this issue, Staff would point out to the Commission that the Companies, in arguing against the PO's correct conclusion on another issue that A&P is a better method of allocating distribution system costs than CP, most likely unwittingly point out the inconsistency of requiring residential non-heating customer service classification ("SC") 1N customers to pay more for the same volume of gas deliveries than a residential heating customer billed under SC 1H. In their argument against A&P, the Companies indicate that it would be expected that a SC 1N customer would have less of an impact on distribution system costs than a SC 1H customer because the SC 1N customer would be expected to have a better load factor than a SC 1H customer, thereby requiring less incremental capacity to service the SC 1N customer's peak demand than the SC 1H customer's peak demand. (Companies BOE at 74) Staff's BOE explained how it is unreasonable for a SC 1N customer with a fairly large volume of usage to pay more than a SC 1H customer who has the same volume of gas delivered, but that would be the result of the Companies' proposal for SC 1N rates despite the Companies own recognition that SC 1N customers do not impact distribution system costs to the extent as SC 1H customers. (Staff BOE at 82-85)

The Companies' comparison of the effect on distribution system costs between SC 1N and SC 1H customers is not persuasive as it pertains to A&P because A&P adequately balances distribution system costs affected by increases in demand and distribution system costs that are unaffected by increases in capacity installed. In explaining that SC 1N have a smaller effect on distribution system costs than SC 1H customers, the Companies demonstrate that the Companies' SC 1N and SC 1H proposals are flawed because those proposals would require SC 1N customers to pay more than SC 1H customers for the same higher volumes of gas. As Staff explained in its BOE, the Commission should reject the PO's conclusion that the Companies' SC 1N and SC 1H proposals "represent the most reasoned approach to establishing just and reasonable rates for small residential heating and non-heating customers." (PO at 239) Instead, the Commission should conclude that the Companies' SC 1N and 1H proposals are incomplete at this time, and can cause unreasonable billing results for SC 1N customers compared to SC 1H customers. As a result, cost and billing information for SC 1N and SC 1H customers should be combined to retain the current handling of residential rates, in which all residential customers are billed under a single rate structure, setting the North Shore customer charge $15.79 or less per month and the Peoples Gas customer charge set at $14.69 or less per month. (Staff BOE at 84; ICC Staff Exhibit 19.0 at 12, lines 228-231)

X. TRANSPORTATION ISSUES

C. Large Volume Transportation Program

1. Rider FST and 2. Rider SST

CNE-G, Vanguard and the Companies have agreed amongst themselves on a settlement of various issues concerning the parameters of Riders FST and SST. (CNE-G BOE at 2-5) Staff notes that it was not a party to the settlement, and the settlement does not include IIEC, Multiut, Nicor Advanced Energy, City-Cub and AG. Since the agreement is not unanimous, Staff continues to advocate its stated positions and will only comment on the proposed exceptions put forth by each of the parties. In particular, Staff notes that for Rider FST, it argued that the MDN approach was appropriate, since Rider FST customers do not have a demand meter. But for Rider SST, it advocated that delivery restrictions could continue to be based upon MDQ. In that sense, it disagrees with the parties to the settlement about the restrictions that should be placed upon daily withdrawals from and injections to storage.

Whether or not the settlement is accepted in total or not, Staff does not object that the minimum storage level on November 30 equal to 75% for North Shore rather than 85% (CNE-G BOE at 3-4) as advocated by the Companies.

4. Injection, Withdrawal and Cycling Requirements

IIEC argues that the Commission should reject the requirement that forces customers to inject gas equal to at least 70% of the customer's AB for Peoples and at least 85% of the AB for North Shore into the Companies' storage facilities by November 30 of each year. (IIEC BOE at 2-5) Multiut is also against this proposal. (Multiut BOE at 1-2) Staff opposes the IIEC and Multiut on their exception to the PO. The Companies face various restrictions on their use of storage. On leased storage, they have tariff restrictions; and on Manlove Field there are operational constraints. The users of storage besides the Companies should have to conform in some fashion to these constraints, or they will impose costs on sales customers. Staff opposes the eliminating this restriction. (Staff RB at 105) However, Staff is not taking exception to the elimination of the spring requirement to empty storage, nor is Staff opposed to reducing the November 30 limit from 85% to 75% for North Shore. (CNE-G BOE at 3-4).

5. Unbundled Storage Bank ("USB")

The IIEC took exception to the PO on the issue of Unbundled Storage Service ("USB"). (IIEC BOE at 5-11) ``Staff reiterates its opposition to USB as espoused by IIEC. (Staff RB at 254-255) In Staff's view, the service is illegitimate since it attempts to get the Companies to set aside the lowest cost storage service Manlove Field for transportation customers, whereas sales customers are left to pay for the more expensive leased storage services. This discriminates against sales customers by raising their costs. (Id.) Accordingly, the IIEC's exception should be rejected.

6. Rider P-Pooling

b. "Super-pooling"

CNE-G argues that super-pooling can be used for all purposes (applying unauthorized use penalties on critical days or imbalance account charges on supply surplus days) not just to determine compliance with the November 30 injection targets. (CNE-G BOE at 5) Staff does not agree that super-pooling is necessary at this time, because there are issues that are unresolved. Accordingly, CNE-G's exception should be rejected.

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

1. Storage Rights and Aggregation Rights

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

RGS takes exception to the PO on the issue of Rider AGG. (RGS BOE at 6-8) Staff does not support RGS' proposed Rider AGG. Staff's position is that the current structure is reasonable. It did support the increases in daily and month-end delivery flexibility. However, RGS here seeks to prove its case by contrasting the treatment that Rider FST customers receive to the conditions that CFY customers face. For example, it states that RGS' proposed delivery rights for CFY customers are modest when compared to the rights afforded to FST customers in the ALJPO. (RGS BOE at 11-13) However, CFY customers are residential and small commercial customers while Rider FST customers will typically be larger commercial customers. In any case, RGS does not consider how those differences should affect the relative amount of flexibility that each group should receive.

Accordingly, the Commission should reject the RSG proposed changes with respect to AGG.

d. Customer Migration

RGS took exception to the PO on the issue of customer migration. RGS argues that the PO's language does not address the problem which RGS's language remedies. (RGS BOE at 30) Staff does not oppose RGS' suggested language to mandate purchases and sales between the Company and marketers when customers migrate between the Company and a marketer. Without this provision, a marketer could be penalized for winning over a customer simply because it is an inconvenient time of year. Since the storage capacity already follows the customer, it should not burden either party to trade gas at the current market price to fill the storage capacity.

2. Customer Enrollment

a. Customer Data Issues

Customer Data Issues-Using information for non utility reasons

NAE argues that CFY customers should be able to provide their data to any party they want. (NAE BOE at 1-2) Staff does not object to customers exercising their commercial rights, while Staff continues to advocate that marketers not be able to re-sell the data. However, Staff opposes the proposed change by NAE. The language currently in the Proposed Order is sufficient, while the new language seems to invite "any party" seeking private customer information without a legitimate utility reason. The proposed language should be rejected.

Customer Data Issues-Data Fees

Staff agrees with the concerns expressed by NAE in its exceptions that the Companies can impose unjustified costs on marketers. (NAE BOE at 3-4) Staff also believes that the Companies should have to justify any charges that they wish to impose and file them in a tariff. However, Staff believes that the language that NAE proposes to delete should instead remain in the Order, since it explains the reason for why marketers need to be charged for the service.

b. Evidence of Customer Consent

<u>Response to NAE</u>

NAE has concern with the PO's conclusion regarding a consensus process to address the issue of evidence of customer consent. (NAE BOE at 4-5) NAE does not want the consensus seeking process to delay legitimate and customer-approved information transfers. Staff, to some extent, shares that concern. However, Staff believes that the benefits from the protection of customer information established in the Proposed Order outweigh the concern about delay and would be jeopardized by the NAE proposal.. Staff objects to the proposed language to the extent that solutions are imposed upon ratepayers without adequate protections. Staff would delete the proposed language starting with, "…but the timing of…" all the way through "… Tier 2 Data" In its place, Staff would propose that the Companies be given a deadline to for putting forth a method for implementing this portion of the Order if the Commission is concerned that the program is unnecessarily delayed.

<u>Response to CNE-G</u>

Further, Staff reiterates its position that customer consent for release of any personal customer information always be required as discussed in Staff's BOE (Staff BOE at 88-89). Thus the CNE-G settlement to the extent that it impacts the issue of customer consent (CNE-G BOE at 3, item (13) ("Any of the issues under "8. Other Large Volume Transportation Issues" including approval of the utility provision of service classification, rider, allowable bank, maximum daily quantity, and selected standby percentage information to a supplier upon customer consent (X.C.8.d.))(emphasis added)should be rejected by the Commission.

4. Purchase of CFY Supplier Receivables

RGS takes issue with the PO with regard to the issue of purchase of receivables. (RGS BOE at 23-29) Staff never denied that there were benefits associated with POR. However, Staff does believe that the benefits and costs are not distributed equitably. In particular, Staff argues that the benefits to CFY marketers and their customers are offset by costs being borne by other customers. As Staff argued in its initial and reply briefs (Staff IB, 264; Staff RB, 110), the risk of uncollectible debt (and their resulting costs) are shared between CFY customers and sales customers. As RGS acknowledges, bad debt costs have been removed from CFY customer rates by the Companies' proposal in this docket. This relieves CFY customers from paying this cost. It does not make any sense at this juncture to then turn around and create a reverse flow by imposing a POR on all sales customers.

RGS argues that the significance of Public Act 095-0700 cannot be understated. (RGS BOE at 24-25) But, the salient fact is that Public Act 095-0700 does not apply to the gas industry, and, as such, it cannot be concluded that a POR program for the gas industry is the will of the Legislature.

Further, as the Staff has noted in its initial brief, Staff is leery of allowing utility service being held hostage for nonpayment of a competitive service. (Staff IB at 264) While some jurisdictions have adopted a POR, that is certainly not decisive in Illinois. It goes without saying, that each state has different regulatory structures with different legislative configurations. There is nothing in Illinois law or rule that imposes or even suggests such a scheme in Illinois. Accordingly, the Commission should reject the RSG proposed changes with respect to purchase of receivables.

XII. UNION PROPOSALS

B. Audit of Repairs and Staffing

The PO directs that an audit be conducted with respect to leak repairs. (PO at 297) In their exceptions, the Companies suggest the PO errs because Section 8-102 of the Act controls and the instant situation does not meet the Section 8-102 requirements. (220 ILCS 5/8-102) The Companies further argue that "[n]owhere in the record is evidence of employees or customers involved in accidents, of buildings being evacuated due to the failure of temporary repairs, or any other evidence of an actual safety issue." Staff has two concerns about this argument.

First, While Section 8-102 may control, the Proposed Order noted that other sources of authority for an audit may exist. (PO at 296) The Commission may desire to clarify the statutory authority relied upon in the "Commission Conclusion" section of this issue.

Second, Staff has reservation regarding the statement that there has been no "accident" or other manifestation of damage from the leak incident because it suggests that the Commission cannot audit or investigate safety issues unless the problem has actually resulted in some sort of damage or injury to person or property. Staff believes it is an improper interpretation of the type of safety concerns that can justify a Commission audit or investigation. The Commission does not have to wait for someone or something to be damaged or injured before the Commission investigates and/or takes action.

Finally, the Companies request that Staff be involved with the audit if the Commission orders such an audit. The Companies state "[h]owever, there is an additional entity that has expertise in this subject and that is the Commission Staff, specifically the Natural Gas Pipeline Safety Section. Accordingly, Peoples Gas recommends that, if an audit is required, the Proposed Order be revised to eliminate the request for specific statistics and, instead, direct Peoples Gas to work with the Commission's Pipeline Safety Section and Local 18007 to develop the appropriate focus of the audit, including the statistics to be reported. See Exception No. 28 in the NS-PGL Exceptions." Staff's Pipeline Safety Program personnel are more than willing to work with Peoples Gas and the Local to establish a mutually acceptable scope and set of "reportables" for the audit.

CONCLUSION

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

Respectfully submitted,

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Counsel for the Staff of the Illinois Commerce Commission

December 21, 2007

The Peoples Gas Light and Coke Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Item (B)	Amount (C)	Lag (Lead) (D)	CWC Factor (E) (D/365)	CWC Requirement (F) (C*E)	Column C Source (G)
1	Revenues	$ 1,350,489	49.44	0.13545	$ 182,927	PO Appendix A page 11
2	Pensions and Benefits	**32,833**	(28.50)	(0.07808)	(2,564)	**ICC RBOE Appendix A page 3 line 6**
3	Payroll and Withholdings	**56,765**	(14.23)	(0.03899)	(2,213)	**ICC RBOE Appendix A page 3 line 13**
4	Inter Company Billings	66,656	(36.22)	(0.09923)	(6,614)	Company Schedule C-13, Page 1 of 4, Column C, Line 14
5	Natural Gas	1,084,326	(42.05)	(0.11521)	(124,920)	ICC Staff Ex. 13.0, Sch. 13.7 P, Column B, Line 2
6	**Other Operating Expenses**	**70,826**	(49.51)	(0.13564)	(9,607)	**ICC RBOE Appendix A page 2 line 16**
7	Taxes Other Than Income and Real Estate	224,009	(43.67)	(0.11964)	(26,801)	PO Appendix A page 13
8	Real Estate Taxes	-	-	0.00000	0	
9	Interest Expense	24,392	(76.99)	(0.21093)	(5,145)	PO Appendix A page 7
10	Federal Income Tax	60,581	(37.88)	(0.10378)	(6,287)	PO Appendix A page 1
11	State Income Tax	9,864	(37.88)	(0.10378)	(1,024)	PO Appendix A page 1
12	TOTAL				$ (2,248)	Sum of Lines 1 through 11
13	Cash Working Capital per Order		**$ (2,248)**			Line 12
14	Cash Working Capital per Company		30,896			Company Exhibit SF-2.1P, Line 4
15	Difference -- Adjustment		$ (33,144)			Line 13 minus Line 14

Note: Bold font represents Staff changes to PO.

The Peoples Gas Light and Coke Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Revenues (B)		Amount (C)	Source (D)
1	Total Operating Revenues	$	453,457	PO Appendix A page 1 Line 5
2	PGA Revenue		1,084,326	ICC Staff Ex. 13.0, Sch. 13.7 P, Column B, Line 2
3	Uncollectible Accounts		(39,090)	PO Appendix A page 1 Line 6
4	Depreciation & Amortization		(59,203)	PO Appendix A page 1 Line 14
5	Return on Equity		(89,001)	PO Appendix A page 1 Line 24
6	Total Revenues for CWC calculation	$	1,350,489	Sum of Lines 1 through 5
	Other Operating Expenses			
7	Total Return on Rate Base			
8	Percentage Equity		56.00%	ICC Staff Ex. 17.0, Schedule 17.1
9	Return on Equity	$	-	Line 7 times Line 8
10	**Operating Expenses**	$	325,373	PO Appendix A page 1 Line 19
11	Pensions and Benefits		**(32,833)**	**RBOE App. A p. 3 line 6**
12	Payroll and Withholdings		**(56,765)**	**RBOE App. A p. 3 line 13**
13	Uncollectible Accounts		(39,090)	PO Appendix A page 1 Line 6
14	**Depreciation & Amortization**		**(59,203)**	**PO Appendix A page 1 Line 14 column (i]**
15	Inter Company Billings		(66,656)	Company Schedule C-13, Page 1 of 4, Column C, Line 14
16	**Other Operating Expenses**	$	70,826	**Sum of Lines 10 through 15**

Note: Bold font represents Staff changes to PO.

The Peoples Gas Light and Coke Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Description (B)	Amount (C)	Source (D)
	Adjustments to Reflect Company's ProForma Adjustments		
1	Pensions and Benefits per Company Filing	**$ 31,011**	**Company Schedule B-8, p. 1 of 2, Col. (H), line 1**
2	Medical & Insurance Cost Adjustment	2,592	Company Schedule C-2.10, Line 11
3		-	
4	Pension Cost Decrease	(770)	Company Schedule C-2.15, Line 11
5		-	
6	Pensions and Benefits per Order	$ 32,833	Sum of Lines 1 through 5
	Other Operating Expenses		
7	**Payroll and Withholdings**	**$ 58,223**	**Company Schedule B-8, p. 1 of 2, Col. (H), line 2**
8	Annualize O&M Union Wage & Nonunion Merit Increases 2006	605	Company Schedule C-2.13, Line 11
9		-	
10	Annualize O&M Union Wage & Nonunion Merit Increases 2007	1,550	Company Schedule C-2.14, Line 11
11		-	
12	Adjustment for Incentive Compensation	(3,613)	PO Appendix A page 2 column(f) line 13
13	Direct Payroll per Order	$ 56,765	Sum of Lines 7 through 12

Note: Bold font represents Staff changes to PO.

The Peoples Gas Light and Coke Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Dollars)

Weighted Expense Lead Times per Company's WPB-8, Page 95 of 99

Line	Tax	Amount	Percent of Total Amount	Lead	Weighted Lead	Source
(A)	(B)	(C)	(D)	(E)	(F)	(G)
			(C/sum(C))		(D * E)	Company WPB-8, Taxes, Page 95 of 99:
1	FICA	$ 14,046,840	6.27%	15.88	1.00	Line 1
2	FUTA	91,640	0.04%	76.38	0.03	Line 2
3	SUTA	1,095,706	0.49%	73.38	0.36	Line 3
4	ICC Gas Rev. (PUF)	1,660,000	0.74%	(32.52)	(0.24)	Line 4
5	Invested Capital	8,596,416	3.84%	30.06	1.15	Line 5
6	Federal Excise	15,701	0.01%	73.27	0.01	Line 6
7	**Other Operating Expenses**	121,735,397	54.34%	52.88	28.74	Line 7
8	Energy Assistance	9,342,547	4.17%	42.65	1.78	Line 8
9	Corp. Franchise	165,306	0.07%	184.86	0.14	Line 9
10	Gas Rev./ Pub. Util.	38,732,399	17.29%	5.45	0.94	Line 10
11	Illinois Gas Use	270,100	0.12%	42.64	0.05	Line 11
12	Illinois Motor Fuel	50,244	0.02%	42.65	0.01	Line 12
13	Property/R. E.	2,215,342	0.99%	380.09	3.76	Line 13
14	Chicago Payroll	70,244	0.03%	79.29	0.02	Line 14
15	Chicago Use	188,191	0.08%	235.86	0.20	Line 15
16	Chicago Gas Use	25,720,198	11.48%	49.78	5.72	Line 16
17	Chicago Gas Lease	1,507	0.00%	49.78	0.00	Line 17
18	Chicago Cars/MV	11,292	0.01%	52.82	0.00	Line 18
19	Totals	$ 224,009,070	100.00%		43.66	

North Shore Gas Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Item (B)	Amount (C)	Lag (Lead) (D)	CWC Factor (E) (D/365)	CWC Requirement (F) (C*E)	Column C Source (G)
1	Revenues	$ 266,876	41.08	0.11255	$ 30,036	PO Appendix B page 11
2	Pensions and Benefits	**4,614**	(40.92)	(0.11211)	(517)	**ICC RBOE Appendix B page 3 line 6**
3	Payroll and Withholdings	**5,057**	(14.83)	(0.04063)	(205)	**ICC RBOE Appendix B page 3 line 13**
4	Inter Company Billings	17,234	(36.78)	(0.10077)	(1,737)	Company Schedule C-13, Page 1 of 2, Column C, Line 14
5	Natural Gas	226,316	(41.84)	(0.11463)	(25,943)	ICC Staff Ex. 13.0, Sch. 13.7 N, Column B, Line 2
6	**Other Operating Expenses**	**7,916**	(55.35)	(0.15164)	(1,200)	**ICC RBOE Appendix B page 2 line 16**
7	Taxes Other Than Income and Real Estate	21,026	(40.28)	(0.11036)	(2,320)	PO Appendix B page 13
8	Real Estate Taxes	-		0.00000	0	
9	Interest Expense	4,320	(91.25)	(0.25000)	(1,080)	PO Appendix B page 7
10	Federal Income Tax	2,232	(37.88)	(0.10378)	(232)	PO Appendix B page 1
11	State Income Tax	11	(37.88)	(0.10378)	(1)	PO Appendix B page 1
12	TOTAL				$ (3,199)	Sum of Lines 1 through 11
13	Cash Working Capital per Order		**$ (3,199)**			Line 12
14	Cash Working Capital per Company		(1,124)			Company Exhibit SF-2.1N, Line 4
15	Difference -- Adjustment		$ (2,075)			Line 13 minus Line 14

Note: Bold font represents Staff changes to PO.

North Shore Gas Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Revenues (B)	Amount (C)	Source (D)
1	Total Operating Revenues	$ 62,646	PO Appendix B page 1 Line 5
2	PGA Revenue	226,316	ICC Staff Ex. 13.0, Sch. 13.7 N, Column B, Line 2
3	Uncollectible Accounts	(1,975)	PO Appendix B page 1 Line 6
4	Depreciation & Amortization	(6,094)	PO Appendix B page 1 Line 14
5	Return on Equity	(14,017)	PO Appendix B page 1 Line 24
6	Total Revenues for CWC calculation	$ 266,876	Sum of Lines 1 through 5
	Other Operating Expenses		
7	Total Return on Rate Base		
8	Percentage Equity	56.00%	ICC Staff Ex. 17.0, Schedule 17.1
9	Return on Equity	$ -	Line 7 times Line 8
10	**Operating Expenses**	$ 42,890	PO Appendix B page 1 Line 19
11	Pensions and Benefits	**(4,614)**	**RBOE App. B p. 3 line 6**
12	Payroll and Withholdings	**(5,057)**	**RBOE App. B p. 3 line 13**
13	Uncollectible Accounts	(1,975)	PO Appendix B page 1 Line 6
14	**Depreciation & Amortization**	**(6,094)**	**PO Appendix B page 1 Line 14 column (i**)
15	Inter Company Billings	(17,234)	Company Schedule C-13, Page 1 of 2, Column C, Line 14
16	**Other Operating Expenses**	$ 7,916	**Sum of Lines 10 through 15**

Note: Bold font represents Staff changes to PO.

North Shore Gas Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Thousands)

Line (A)	Description (B)		Amount (C)	Source (D)
	Adjustments to Reflect Company's ProForma Adjustments			
1	Pensions and Benefits per Company Filing	**$**	**4,765**	**Company Schedule B-8, p. 1 of 2, Col. (H), line 1**
2	Medical & Insurance Cost Adjustment		144	Company Schedule C-2.10, Line 11
3			-	
4	Pension Cost Decrease		(295)	Company Schedule C-2.15, Line 11
5			-	
6	Pensions and Benefits per Order	$	4,614	Sum of Lines 1 through 5
	Other Operating Expenses			
7	**Payroll and Withholdings**	**$**	**5,220**	**Company Schedule B-8, p. 1 of 2, Col. (H), line 2**
8	Annualize O&M Union Wage & Nonunion Merit Increases 2006		93	Company Schedule C-2.13, Line 11
9			-	
10	Annualize O&M Union Wage & Nonunion Merit Increases 2007		167	Company Schedule C-2.14, Line 11
11			-	
12	Adjustment for Incentive Compensation		(423)	PO Appendix B page 2 column(f) line 13
13	Direct Payroll per Order	$	5,057	Sum of Lines 7 through 12

Note: Bold font represents Staff changes to PO.

North Shore Gas Company
Adjustment to Cash Working Capital
For the Test Year Ending September 30, 2006
(In Dollars)

Weighted Expense Lead Times per Company's WPB-8, Page 32 of 36

Line	Tax		Amount	Percent of Total Amount	Lead		Weighted Lead	Source
(A)	(B)		(C)	(D)	(E)		(F)	(G)
				(C/sum(C))			(D * E)	Company WPB-8, Taxes, Page 32 of 36:
1	FICA	$	1,721,804	8.19%	16.70	PO	1.37	Line 1
2	FUTA		11,996	0.06%	76.38		0.04	Line 2
3	SUTA		61,774	0.29%	76.38		0.22	Line 3
4	ICC Gas Rev. (PUF)		320,000	1.52%	(32.99)		(0.50)	Line 4
5	Invested Capital		1,259,560	5.99%	30.03		1.80	Line 5
6	Federal Excise		42	0.00%	73.27		0.00	Line 6
7	**Other Operating Expenses**		7,476,564	35.56%	76.35		27.15	Line 7
8	Energy Assistance		1,565,589	7.45%	42.18	PO	3.14	Line 8
9	Corp. Franchise		24,757	0.12%	179.39		0.21	Line 9
10	Gas Rev./ Pub. Util.		8,337,399	39.65%	6.37		2.53	Line 10
11	Illinois Gas Use		6,543	0.03%	42.55		0.01	Line 11
12	Illinois Motor Fuel		110	0.00%	42.09		0.00	Line 12
13	Property/R. E.		240,105	1.14%	377.39		4.31	Line 13
14	Totals	$	21,026,243	100.00%			40.28	

Note: Bold font represents Staff changes to PO.