

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

NORTHERN ILLINOIS GAS COMPANY	:	
d/b/a Nicor Gas Company	:	
	:	No. 08-0363
	:	
Proposed general increase in natural gas rates	:	

**REPLY BRIEF OF THE ILLINOIS INDUSTRIAL ENERGY CONSUMERS**

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## **I. INTRODUCTION**

The Companies intervened in this case as the Illinois Industrial Energy Consumers (“IIEC”), will respond to certain arguments made by Northern Illinois Gas Company (“Nicor” or “Company”), and the Staff of the Illinois Commerce Commission (“Staff”). IIEC’s failure to address the arguments or positions of any party should not be considered as agreement with those positions, unless otherwise specifically stated in this brief.<sup>1</sup>

Specifically, IIEC addresses issues and arguments relating to cost of service and the allocation of the Nicor revenue requirement, the design of Rates 7 and 77, and tariff revisions affecting transportation customers.

## **VII. COST OF SERVICE AND ALLOCATION ISSUES**

### **A. Overview**

Nicor, for the purpose of narrowing the issues, supports the use of the Average and Peak (“A&P”) method for allocation of distribution main costs, within its Embedded Cost of Service Study (“ECOSS”). (Nicor Br. at 60). Nicor also proposes the use of its Modified Distribution Main (“MDM”) study in conjunction with the A&P method. (*Id.*). Nicor notes that both the A&P method and the use of the MDM study were approved by the Commission in Nicor’s last rate case. (*Id.*)<sup>2</sup> Staff essentially agrees with Nicor. (Staff Br. at 71-72).

Nicor proposes that Rate 1 customers be assigned 97.5% of their cost responsibility (Nicor Br. at 60) and to allocate the resultant revenue shortfall to non-residential customers ostensibly

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<sup>1</sup> IIEC has organized its brief in accordance with the approved outline for this case, but references only the captions relevant to IIEC issues and arguments.

<sup>2</sup> Nicor’s last rate case was Northern Illinois Gas Company, d/b/a Nicor, ICC Dkt. No. 04-0779, Final Order, September 20, 2005 and will be referred to as the “2004 Rate Case” in this Reply Brief. Citations to the Final Order of September 20, 2005 in that case will be made as the “2004 Rate Case Order.”

based on the Equalized Percent Embedded Cost (“EPEC”) method. (*Id.* at 65). Staff agrees with Nicor. (Staff Br. at 75-76).

Nicor and Staff oppose IIEC’s recommendation to apply the Nicor MDM study to the volume-related component of distribution mains as well as the demand-related component. (Nicor Br. at 61, 62-63; Staff Br. at 74-75). Nicor also opposes IIEC’s recommendation that storage costs be allocated to transportation customers on the basis of the revenue recovered from transportation customers through a cost-based storage charge. (Nicor Br. at 63-65). Both Staff and Nicor oppose IIEC’s proposal to move rates to cost of service in this proceeding. (Nicor Br. at 65-66; Staff Br. at 76-77). IIEC responds to these positions below.

### **C. Contested Issues**

#### **1. Main Size Allocation**

Nicor and Staff oppose IIEC’s recommendation that the results of the Nicor MDM study be applied to both the average demand component and the volume-related component of Nicor’s distribution mains. (Nicor Br. at 62-63; Staff Br. at 74-75; IIEC Br. at 5-10). However, there is an important difference in their positions. Nicor recognizes the logic and merit of IIEC’s recommendation, stating that it is agreeable to investigating this approach on a going-forward basis. (Nicor Br. at 63). Staff, on the other hand, suggests that IIEC’s approach is misguided and should be rejected completely. (Staff Br. at 74).

The Staff Brief describes IIEC’s proposal as one that seeks to revise Nicor’s A&P allocation. (Staff Br. at 74). The Staff Brief mischaracterizes IIEC’s proposal, which is to more broadly apply the MDM study, as one that involves classification of utility plant as peak demand or average demand/volume-related. The A&P method is concerned with the classification of mains and the MDM method is concerned with the allocation of mains. (Rosenberg, IIEC Ex. 1.0 at 5). The two

(classification and allocation) are not related as Staff's brief implies. (*see, Id.*). A key step in any cost of service study is called classification. As IIEC witness Dr. Rosenberg explained,

“The second step, Classification, divides the functionalized plant or expense into three major categories, which are typically Annual Throughput (or Volume), Demand, and Customer. This is done by examining which service characteristic is deemed to be most directly responsible for the incurrence of the cost. Purchased gas costs, for example, are clearly related to volume. Demand costs are those that are not influenced by annual usage, but rather are more or less responsive to the peak demands of the customers. Normally, any piece of equipment that must be sized to a certain capacity (therms per day or therms per hour) is therefore considered demand-related. Customer-related costs are those that are insensitive to either annual usage or peak demands, but instead respond to the number of customers on the system.” (Rosenberg, IIEC Ex. 1.0 at 3-4).

All parties in this case agree the A&P method should be used to classify Nicor's distribution mains as part demand-related (approximately 77%), and part volume-related (approximately 23%).<sup>1</sup> (Mudra, Tr. 362).

The MDM study, however, does not influence, nor is it influenced by, the *classification* step. Rather, the MDM study results are used only during the allocation step of the ECOSS. (*see, Rosenberg, IIEC Ex. 1.0 at 5*). The application of the MDM study recognizes the fact that the distribution system is not an amorphous “blob” of mains from which all customers are served equally, but can instead be likened to the branches of a tree, with gas flowing from the larger diameter mains to the smaller diameter mains. (*Id.* at 6-7). It also recognizes that some customers take service directly from the larger diameter mains, and hence their gas never reaches the smaller diameter mains. (*Id.* at 7). This is analogous to an electric distribution system where some customers are served at primary voltage levels and make no use of the facilities that operate at secondary voltage levels.

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<sup>1</sup> Since average demand is simply annual volume divided by a constant, 365 days, volume and average demand are equivalent as far as allocation is concerned. (Mudra, Tr. 370-371).

When Nicor uses the MDM study results in its allocation of the demand-related portion of main costs, it not only separates those costs by main diameter, but also “modifies” the class demands so that each class is allocated only the costs associated with mains of equal or larger diameter as those that serve the members of the class. (*Id.* at 6; Rosenberg, IIEC Ex. 2.0 at 20-21). For example, if all members of a class utilize a certain diameter of main, then the full demand of that class is used in the allocation step. However, if the MDM study shows that only 10% of a class (as measured by demand) uses a certain diameter of main, then only 10% of the demand of that class is used to allocate the cost of that diameter of main.

Mr. Mudra has agreed that this “modification” process increases the accuracy of the study, and indeed that this was the *raison d’être* of the MDM study. (Mudra, Tr. 382). Even Staff witness Lazare agreed that the MDM study was premised on the fact that significant portions of the load of the large volume rate classes were not served by small diameter mains and this fact should be recognized in the allocation process. (Lazare, Tr. 521).

Nevertheless, while Nicor applied the MDM study results in its allocation of demand-related costs, it failed to recognize and reflect those results in the allocation of the volume-related mains costs. Nicor’s inconsistency in applying the MDM results to both demand and volume-related costs is a significant deficiency in its cost study, a deficiency which Dr. Rosenberg has been able to resolve using exactly the same principles as those described above. The only difference is that while Nicor modified only peak demands, Dr. Rosenberg has also modified the *average demands* to produce results that can reasonably be applied to the volume-related portion of mains costs.

Moreover, IIEC’s proposal is completely in accord with the philosophy recently embraced by the Commission in Commonwealth Edison Company, ICC Docket 07-0566. In that case, the matter concerned whether customers served from primary distribution lines should be allocated the

costs associated with secondary lines. If we substitute “mains” for “lines,” “large diameter” for “primary” and “small diameter” for “secondary,” that is exactly analogous to the MDM issue at hand – namely whether customers served from large diameter mains should be allocated the costs associated with small diameter mains which they neither use nor need. In Docket 07-0566, the Commission stated that arguments against the proper assignment of primary and secondary costs overlooked:

“ . . . our explicit policy objective of assigning costs where they belong. Only customers using the primary system would see lower rates but the assignment of costs and the rates charged to all classes would be effected (sic). Moreover, the secondary costs assigned to these primary customers substantially change the cost of serving this small number of customers.

\* \* \* \*

. . . the Commission finds that the ECOSS is deficient in not separating and properly allocating primary and secondary service costs.” (Commonwealth Edison Company, ICC Dkt. 07-0566, Final Order, September 11, 2008, at 206-207).

Likewise, in the case at bar, it would be inappropriate to assign costs of smaller distribution mains to non-residential customers who make little or no use of those mains, and thus, assign costs where they do not belong in violation of Commission policy.

**a. Response to Staff**

Staff declined its opportunity to rebut or refute IIEC’s proposal in its rebuttal testimony – and the Staff declined to cross-examine IIEC witness Dr. Rosenberg on the proposal. The Staff now belatedly takes issue with IIEC’s suggestion to use the MDM study in a consistent manner with respect to the volume-related portion. The Staff makes the following argument:

“The problem with the [Dr. Rosenberg’s] argument is that it fails to understand the purpose of the average component of the A&P in the allocation of T&D costs. As Staff noted in testimony, the average demand component ‘recognizes the role of year-round demands in shaping transmission and distribution investments.’ (Staff Ex. 7.0, pp. 25-26) Stated

otherwise, the Company requires year-round demands by all customers to justify the investment in a T&D system which consists of both large and small mains.” (Staff Br. at 74, *explanation added*).

Staff’s argument is a red herring. As IIEC has demonstrated above, Staff’s position would have relevance only in the context of an argument about the appropriate method to use to classify Nicor’s distribution mains (e.g., Coincident Peak method or the A&P method). But the classification of Nicor’s distribution mains is not at issue in this case. IIEC and Nicor have accepted, for purposes of this case, that “year-round” demands play a role in cost causation. The pertinent question is *which* average (or “year-round” to use the Staff terminology), demands should be used? If a customer takes service directly from an 8-inch main, that customer will not impose any demand on 2-inch main, regardless of whether that demand is a peak or average demand: the customer simply will not use or need the smaller size mains on any day of the year and Nicor should not apply that customers’ demand when allocating costs associated with the smaller size mains for the simple reason that such demand does not exist. To argue anything else is nonsensical.

Next Staff argues:

“ . . . it would be considerably less viable on an economic basis for Nicor Gas to build a distribution system consisting of larger mains to serve only large nonresidential customers.” (Staff Br. at 75). (*emphasis added*)

Staff provides no citation to the record for this assertion. Absolutely no support for this allegation is found anywhere in the record. Nor can such an inference be reasonably drawn from the evidence. In fact, just the opposite is the case. There is evidence, presented by IIEC and corroborated by Nicor, of the economies of scale for large diameter mains. (Rosenberg, IIEC Ex. 2.0 at 27-28; *see*, Mudra, Nicor Ex. 48.0-2<sup>nd</sup> C at 35). Also, the inverse relationship between customer size and the cost per Mcf of gas is demonstrated in the Nicor cost of service study. (Rosenberg, IIEC Ex. 2.0 at 28). That cost of service study has been fully accepted by the Staff. (Staff Br. at 71). Thus, the only

legitimate inference that can be drawn from the evidence in the record, is that if only large non-residential customers were being served, Nicor could very well have designed and installed a distribution system consisting of only large diameter mains, which would have been much less expensive per unit of capacity.

The next statement in Staff's argument against reflecting the MDM implications in the allocation of the volume-related component of the mains is:

“Smaller customers pay a significant share of the costs of larger sized mains. For example, residential customers alone account for more than 52% of peak demand and 47% of throughput on the system.” (Staff Br. at 75).

This statement is generally true,<sup>2</sup> but irrelevant. The percentage values discussed by Staff were taken from Nicor's ECOSS, but they are not the values Nicor used to allocate main-related costs. As such, it is difficult to see how these particular numbers are applicable to the issue at hand.

In contrast, Rate 1 residential customers account for 83.65% of the peak day demand on Nicor's system of 2-inch diameter mains, and Rate 77 represents only 0.2% of the peak demand on 2-inch mains.<sup>3</sup> Further review shows that residential customers account for 73.64% of the design day demand on Nicor's entire system of distribution mains. (Rosenberg, IIEC Ex. 1.1, Ln. 1, Col. B). While it is reasonable to assume that the residential class' *average day* demand on 2-inch mains will be a somewhat lesser percentage than its design day demand – because they do have a relatively

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<sup>2</sup> Staff cites to Nicor Exhibit 15.1, Schedule H, Page 4 in support of its statement. This same citation also shows that residential customers account for almost 57% of firm demand and 91% of the number of customers. Thus the residential customers are already disproportionately and unduly advantaged by the decision to classify mains as part demand and part **volume-related** instead of part demand and part **customer** related.

<sup>3</sup> Nicor Exhibit 14.5, sponsored by Mr. Mudra, shows the cost of distribution main investment by rate class based on the results of the MDM study. (Mudra, Nicor Ex. 14.0-C at 4, 7-8). This exhibit demonstrates that based on peak day demand responsibilities, Rate 1 customers are responsible for 83.6% of the total cost of 2 inch mains. (\$679,367,000 divided by \$813,039,000 equals 83.6%) and Rate 77 is responsible for 0.2%. (\$1,885,000 divided by \$813,039,000 equals 0.2%).

lower load factor – to assume that this average day demand (or “throughput”) will account for only 47% of the total, as the Nicor ECOSS does by ignoring the MDM study, is unreasonable.

Rate 77 represents 7.45% of the total throughput on the system. (Rosenberg, IIEC Ex. 1.1, Ln. 10, Col. C) and so it is allocated 7.45% of all diameter mains for the 23% of the costs that are deemed volume-related by the A&P method. However, as noted above, Rate 77 represents only 0.2% of the peak demand on 2-inch mains. For the Rate 77 class to be allocated responsibly for the cost of 2 inch mains equal to over 35 times its peak day demand ( $35 \times 0.2 = 7.0\%$ ) on these mains is simply unfair and unreasonable.

In summary, Staff has made arguments against IIEC’s recommendation to use the Nicor MDM study to allocate the volume-related portion of distribution mains that mischaracterize IIEC’s proposal and are irrelevant to the issue to be decided. If accepted, such arguments would ensure that cost responsibility for a portion of the Nicor system of distribution mains is imposed on customers who make little or no use of those mains, in violation of the Commission’s explicit policy objective of assigning costs where they belong. Therefore, Staff’s positions should be rejected and IIEC’s recommendation to apply the MDM study to both the peak demand-related component and the volume-related component of Nicor’s distribution mains should be adopted.

**b. Response to Nicor**

Unlike the Staff, Nicor does not raise any theoretical objections to IIEC’s proposal, and indeed, offers to “review IIEC’s proposal and present its conclusions in the Company’s pre-filed testimony in the next rate case”. (Nicor Br. at 63). However, since Nicor could not say when the next rate case will be and it has been approximately three years since Nicor’s 2004 rate case and over 10 years between its 2004 rate case and the prior case, (Mudra, Tr. 314), that is an unsatisfactory response. There is no reason why IIEC’s proposal, as is reflected in Dr. Rosenberg’s

direct testimony, and indeed replicated by Mr. Heintz in his surrebuttal testimony (*see*, Heintz, Nicor Ex. 49.0 at 5-6 and Ex. 49.2), cannot be incorporated in the decision in this case.

In its brief, Nicor has raised two points in particular, to which IIEC wishes to reply. First Nicor argues:

“As such, the Commission should not assume that peak-day percentage allocation factors used within the MDM study would necessarily produce the same result as annual volume percentage allocation factors.” (Citation omitted)

Additionally, given residential customers relatively low load factors as compared to industrial customers, it is reasonable to assume that an allocation based upon peak-day volumes from the MDM study may be different than (sic) an allocation based upon annual consumption.” (Nicor Br. at 63).

In reply, IIEC would draw the Commission’s attention to Dr. Rosenberg’s IIEC Exhibit 1.1, Line 1 Column F. There it can be seen that Dr. Rosenberg’s MDM Volume-related factors are different than the Company’s MDM Peak Demand factors. For instance, while the MDM demand factor is 73.64% for Rate 1, Dr. Rosenberg’s volume-related factor for that class is only 69.03%.

Second, Nicor argues that:

“The uncertainty of IIEC’s proposal also should be considered in relation to the impact it has on residential customers. IIEC’s proposed allocation method would shift \$8,300,000 in costs away from non-residential customers to residential customers.” (*Id.*).

IIEC responds that it would be inappropriate to reject a change to the Commission’s expressed and explicit policy objective of assigning costs where they belong for this reason alone. (Commonwealth Edison Company, ICC Dkt. 07-0566, Final Order, September 11, 2008 at 206). Moreover, even if we were to assume that the \$8,300,000 should be a consideration in whether or not to adopt IIEC’s more accurate allocation, this amount translates into a difference of only about

35 cents per average residential bill, or a little over a penny per day. (Stipulation, Tr. 359). Thus, the impact on residential customers is relatively minor.

In sum, Nicor's arguments to delay any further action on this matter until Nicor's next rate case would impose an unreasonable and unnecessary delay in complying with the Commission's policy objective of assigning costs where they belong, given the significant period of time between Nicor's rate cases. Furthermore, the approach recommended by IIEC does give recognition to the fact that the MDM volume-related factors would ordinarily be somewhat different than the peak demand-related factors applied by Nicor in its use of the MDM study to allocate the peak demand-related portion of its distribution mains. There has been no showing whatsoever that the volume-related factors calculated by IIEC witness Dr. Rosenberg, are unreasonable. Finally, there is minimal impact on the Rate 1 class from adopting IIEC's recommendation to apply the Company's MDM study to the volume-related portion of distribution mains in this case.

For these reasons, Nicor's objections to adoption of IIEC's recommendation at this time should be rejected and the MDM study should be applied to both the volume-related and the peak demand-related portions of the Nicor system of distribution mains.

## **2. Allocation of Storage Costs to Unbundled Transportation Customers**

IIEC proposes that storage cost responsibility for unbundled transportation customers be assigned to those customers so that it equals the revenue recovered from those customers through a cost-based storage charge, *i.e.*, the SBS charge. (IIEC Br. at 10-11). Nicor opposes IIEC's position on several grounds. First, Nicor argues that no other party supports IIEC's storage cost allocation methodology. (Nicor Br. at 64). This is not a basis for rejecting IIEC's position in this case. If it were, then Nicor's request for an overall rate increase in this case should be rejected because no other party has supported that request.

Second, Nicor argues that its approach for allocation of the cost of storage is the same methodology approved by the Commission in past cases. (Nicor Br. at 64). However, Nicor witnesses have already indicated that Nicor would support the use of IIEC's approach under certain circumstances in this case. (*see*, Mudra, Nicor Ex. 48.0-2<sup>nd</sup> C at 32-33). Therefore, even Nicor does not believe that simply because the current method has been accepted in past rate cases, it is inappropriate or improper to adopt the new and more accurate approach recommended by IIEC.

Finally, Nicor argues that IIEC's storage allocation approach is an attempt to solve a problem that does not exist. (Nicor Br. at 64). As IIEC pointed out in its Initial Brief, the fact that there is ostensibly not much difference in the results produced by the current approach and the approach recommended by IIEC, does not guarantee they will produce closely related results going forward. (*see*, IIEC Br. at 10-11). This is because the total revenue requirement, the amount of storage allocated to transportation customers, as well as the denominator to be used in calculation of the SBS charge are all at issue in this case. If they change, then the results produced by the two approaches may not, in fact, be ostensibly the same. In order to eliminate that possibility, IIEC's approach should be adopted.

**D. Interclass Allocation Issues**

Nicor proposed to recover only 97.5% of the applicable cost of service from Rate 1, and ostensibly recover the shortfall from the remaining classes using the EPEC method from the nonresidential classes.<sup>4</sup> (Nicor Br. at 65). Staff defends the first Nicor proposal on the basis of "bill

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<sup>4</sup> Technically, Nicor did not strictly follow this procedure because it did shift revenues between Rate 4 and Rate 74. (Mudra, Tr. 330-333). Thus, the Company is actually proposing revenues for Rate 74 that are \$4.3 million less than that called for by the ECOSS. (The \$4.3 million is derived as the difference between the cost based increase for Rate 74 of \$7.276 million shown on Nicor Exhibit 48.5, Column D, line 9 and the Nicor proposed increase for that same class of \$2.989 million shown on Nicor Exhibit 48.5, Column G, line 9).

impacts” and the “economic difficulties” described in Nicor witness Mr. Fetter’s testimony. (Staff Br. at 76). Staff ignores the deviation from EPEC evidenced in the case of Rate 74, and supports the EPEC method because it is “derived from the ECOSS.” (*Id.*).

Nicor proposes Rate 1 customers be assigned 97.5% of their cost responsibility as measured by the Nicor ECOSS, noting that Rate 1 was assigned 95% of its cost responsibility in the 2004 Rate Case. (Nicor Br. at 65). Nicor’s reluctance to move these customers from 95% of their cost responsibility to 100% of their cost responsibility is based on the principle of gradualism. (*Id.*). Application of this principle, as recommended by Nicor (and the Staff), prevents the Commission from taking the last incremental step of 2.5% to full cost of service for Rate 1. Thus, Nicor will have delayed the movement of these customers to their full cost responsibility for at least five years. (The approximate time period between the filing of Nicor’s 2004 Rate Case and the issuance of a final order in this case in 2009.) The actual time period will be even longer since it is not known when Nicor will file its next rate case. A better description of Nicor’s (and the Staff’s) approach would be “glacial” instead of gradual.

IIEC acknowledges that consideration of bill impacts, or the principle of gradualism as it is termed by Nicor, is a valid reason for tempering the strict indication of the ECOSS. IIEC is even willing to concur with Staff that striking a “reasonable balance between costs and bill impacts” is a matter of judgment. However, that “judgment” should not be applied arbitrarily or capriciously. It is not appropriate to apply one standard of judgment for one class and a different standard for another class. (*see*, Lazare Tr. 523 – agreeing that it is appropriate to consider bill impacts for more than a single rate class). It is unduly discriminatory to rely on bill impact considerations (or ECOSS indications) in a selective and subjective manner. This is what Staff supports and to what IIEC objects.

Take for instance the matter of “bill impacts.” Strict adherence to the ECOSS would entail a 35.6% increase for Rate 1, but nearly a 46% increase for Rate 77.<sup>5</sup> (Mudra, Tr. 324-325, 333). Thus, if Rate 1 is worthy of moderation (amounting to 50 cents per month (Mudra, Tr. 327, 328)), Rate 77 would warrant even more temperance. To do otherwise, as Nicor and Staff propose, is blatantly discriminatory. Yet Nicor and Staff are proposing an increase for Rate 77 (54.3%) that is more than twice the size of the system average increase of 25.86%. (Mudra, Tr. 321, 333-334).

Nicor and Staff have both characterized their proposed increases for Rate 77 as “insignificant” in comparison with the cost of the commodity itself. (*see*, Mudra, Nicor Ex. 29.0-C at 7; Lazare, Tr. 538-539). Acceptance of those arguments would be poor regulatory policy. In the first place, in these perilous times, it is critical that industrial firms minimize their costs wherever possible. The active involvement of IIEC in this proceeding is ample evidence of the importance these firms place on the matter. This rationalization drew the following response from Dr. Rosenberg:

“Finally, I find Mr. Mudra’s third ostensible reason for intentionally overcharging its industrial and other business customers to be quite disturbing. In my years of experience, I cannot recall encountering a responsible witness taking the position that it is quite acceptable to overcharge customers on the basis that they would probably not notice it because commodity prices were so high. In my view, this Commission’s endorsement of such a cynical position, which is of course completely at odds with the principles of cost of service and equity, would send a chilling message to industrial concerns who were considering coming to, or expanding in, the state of Illinois. That attitude would not help the job situation in Illinois in these volatile times.” (Rosenberg, IIEC Ex. 2.0 at 7).

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<sup>5</sup> For reasons of consistency and to avoid confusion, IIEC will rely on the Company surrebuttal ECOSS for purposes of discussion in this section of the Reply Brief, although it is the IIEC’s position that the ECOSS should be modified as discussed elsewhere in this Reply Brief and IIEC’s Initial Brief.

Secondly, this case is concerned with base rates, not purchased gas costs, and neither Staff nor Nicor even know what transportation customers pay for their gas. Moreover, Nicor and Staff are inconsistent on this matter of “significance”. For example, Nicor is still requesting a Rider to track uncollectible expense when Staff has shown that this cost is “insignificant” in relation to its other operating expenses. (Staff Br. at 140). Mr. Lazare still supports higher per therm charges for residential customers to supposedly promote conservation, when the difference between Nicor’s proposed charges and Mr. Lazare’s proposed charges are a tiny fraction of the cost of gas. (*see*, Lazare, Staff Ex. 7.0, Sch. 7.05 at 1 – comparing “Gas Supply Cost” columns to “Difference” columns).

Next, consider Staff’s ostensible reliance on “increasing economic difficulties”, raised in Nicor witness Mr. Fetter’s rebuttal testimony, and seized upon by Staff witness Mr. Lazare as a rationalization for the disparate treatment of the classes. As IIEC witness Dr. Rosenberg noted, this phenomenon of increasing economic difficulty does not apply uniformly to any single class to the exclusion of the other classes, and so is not a legitimate reason to discriminate among the classes. (Rosenberg, IIEC Ex. 2.0 at 4).

Finally, even if one were to accept the notion that Rate 1, and Rate 1 alone, should be constrained to less than its EPEC, the same considerations would mandate this shortfall should be placed squarely on Rates 4 and 74. In the first place, Rate 74 is below its cost of service under the Company proposal. (See Fn. 4 above). And secondly, such treatment would still leave those classes with an increase that is less than the system average increase. (Mudra, Tr. 335).

In closing this section, IIEC has no quarrel with judgmental considerations that balance both cost of service considerations with bill impact concerns. However, IIEC strongly objects to banging the “cost of service” drum when it suits one purpose but not another, and tooting the “bill impact”

horn only for one class but denigrating it for other classes. These issues must be dealt with impartially, logically, and consistently.

## **VIII. Rate Design**

### **A. Overview**

IIEC addresses Staff's arguments in favor of the elimination of the declining block demand charge structure for Rate 77. (Staff Br. at 96-98). IIEC continues to oppose Staff on this issue. Nicor also opposes Staff's elimination of the declining block structure for Rate 77. (Nicor Br. at 78-79).

### **C. Contested Issues**

#### **6. Rate 7 and Rate 77 Charges**

Staff is the *only party* to contest the declining block rate design for the Rate 77 demand charge, a rate design feature that has, heretofore, been repeatedly and consistently approved by this Commission.<sup>6</sup> (*see, e.g.*, 2004 Rate Cast at 105, 151, 156). Instead, Staff has proposed a 1000% increase to the tailblock demand charge. In its Initial Brief, IIEC presented four compelling reasons Staff's proposal for such a drastic increase is ill-conceived and IIEC stands by those reasons, and in particular that such an increase is diametrically opposed to the principle of gradualism. (IIEC Br. at 15-16). In defense of its proposal, the Staff can only offer the vague statement that elimination of the declining block demand charge for Rate 77 is "based on the same principles that drive Staff's rate design for other residential and non-residential customers". (Staff Br. at 96).

However, the Staff's proposal to eliminate a declining block demand charge to large non-residential transportation customers on Rate 77 is entirely different from eliminating a declining

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<sup>6</sup> Staff also opposes declining block commodity charges for other rate classes. IIEC has not taken any position on this matter as it does not directly affect any IIEC members.

block volumetric/commodity-charge for residential customers. In the first place, Staff witness Mr. Lazare's stated objections to a declining block structure are related to Nicor's volumetric/commodity charges in the Nicor proposal for a straight fixed variable rate design for the residential class. (*see*, Lazare, Staff Ex. 7.0 at 32-33, 36). With Rate 77, we are talking about a declining block *demand* charge for non-residential customers. In fact, Rate 77 is basically the only service classification that has a demand charge.<sup>7</sup> (*see*, Mudra, Nicor Ex. 14.4 – describing present and proposed changes for each element of Nicor's rates). In the second place, no other rate class, besides Rate 77, was slated for anything close to a 1,000 percent increase on any of their charges, nor was any other rate class exposed to triple digit increases. (*see*, Lazare, Staff Ex. 7.0, Sch. 7.04 at 1-7; Rosenberg, IIEC Ex. 2.0 at 25-26).

Finally, Mr. Lazare's only support for his radical proposal is the "National Action Plan for Energy Efficiency" that dealt with *electric commodity* rates, and he presented no evidence which established any nexus between the structure of commodity rates for electric service and a non-residential demand charge for gas delivery. Nor did Staff provide any evidence to suggest that Rate 77 customers needed an incentive, in their monthly delivery rates, of any kind to manage their gas consumption efficiently. In fact, except for listing his proposed rate changes in Schedule 7.04 of his direct testimony, Mr. Lazare offered no testimony whatsoever on his radical change to the design of the Rate 77 demand charge.

In its Brief, Staff attempts to refute one argument of Dr. Rosenberg which justifies the declining block demand charge. In particular, Staff cites to Dr. Rosenberg's explanation on economies of scale, namely that the capacity of a distribution main increases exponentially with the diameter of the main, while the cost per foot increases less than linearly in proportion to the

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<sup>7</sup> The companion rate for Rate 77, Rate 7, also has a demand charge.

diameter. (Staff Br. at 97). Mr. Mudra corroborated these facts. (Mudra, Nicor Ex. 48.0- 2<sup>nd</sup> C at 35-36). Thus the cost per unit of capacity is much less for customers served from an 8-inch main than for those served from 4 or 6-inch mains. However, rather than refute this reality, Staff complains that “there is nothing in Mr. Rosenberg’s anecdotal discussion to justify a declining block **of this magnitude** on a cost basis”. (Staff Br. at 97, emphasis added). In other words, Staff is implicitly conceding that a declining block demand charge is justified on the basis of cost to serve, but now is arguing that the *magnitude* of the decline was not adequately supported, and thus would have the Commission decide that no decline *at all* should be approved. What Staff neglects to mention is that it is Staff that is proposing to radically change a relationship among the blocks that has existed, unchallenged, for some 30 years or more. The burden of proof for any change should be upon the party proposing the change. Not only has Staff not met that burden with any embedded cost analysis or marginal cost analysis, it has implicitly conceded that a declining demand charge *is* reasonable. IIEC respectfully submits it is not reasonable to adopt a position that is exactly wrong, because the status quo is only approximately right. Mr. Lazare’s proposed rate design for Rate 77 should be rejected.

## **IX. Tariff Revisions Affecting Transportation Customers**

### **A. Overview**

IIEC will address the positions and arguments of Nicor’s proposed reduction of the Maximum Daily Nomination (“MDN”) for transportation customers, (Nicor Br. at 81-85); and proposals to modify the formulas used to calculate the Storage Banking Service Entitlement and Storage Banking Service Charge (Nicor Br. at 85-89). IIEC will also address the objections of Nicor and the Staff to IIEC’s proposal to liberalize the timing of the Storage Withdrawal Factor calculation. (Nicor Br. at 89-90; Staff Br. at 121-122).

## C. Contested Issues

### 1. Proposed Reductions in Nomination Rights

The Company continues to propose reductions in the MDN rights for transportation customers in the months of March and April and July through October. (Nicor Br. at 81-84). In tacit admission the Company has once again cried wolf,<sup>8</sup> it now says it could “accept” a change to “halve” its proposed reduction in storage injection rights for transportation customers for the relevant months. (Nicor Br. at 82, 84). There are still two major problems with their revised proposal. In the first place, the Company mischaracterizes these revisions as “Staff’s proposals”.

This is grossly incorrect. As Staff makes perfectly clear in its Brief:

Staff’s primary proposal is to make no changes from the current tariff provisions.  
(Staff Br. at 101).

And, in the second place, simply because a proposal is only half as bad as the original one, does not make it either reasonable or necessary.

Nicor attempts to justify the proposed changes to the MDNs on four unsupported assertions by its witness, Mr. Bartlett, on this topic. (Nicor Br. at 82). Specifically, Nicor cites Mr. Bartlett’s claims that:

- From an operational perspective, the daily nomination limit proposals make sense because they more closely match customers’ storage utilization with actual storage field operating requirements.
- Further, such changes are expected to reduce the so-called “additional costs” that the transportation usage patterns allegedly “impose” on sales customers.
- The proposed changes will help reduce the need to “cap” pipeline deliveries.

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<sup>8</sup> In the previous case Nicor had also proposed restrictions on the storage rights of transportation customers that were also ostensibly based on “operation requirements” and allegedly necessary to protect sales customers. Those proposals were, for the most part, soundly rejected by the Commission with no apparent adverse consequences. (*see*, Commission rejection of proposals to require transportation customers to reduce storage balances to 10% by April 1 each year and rejection of Nicor’s proposal to limit transportation customer’s daily nominations. 2004 Rate Case Order at 131 and 146).

- March and April are problematic because transportation customers can nominally inject gas (by nominating more gas than they actually use), despite the fact that the fields are in a withdrawal mode.

It is informative to scrutinize the validity of these claims. The first claim, made in Mr. Bartlett's direct testimony (Bartlett, Nicor Ex. 4.0-C at 25) was accompanied by virtually no analyses, investigations or studies to back it up. In point of fact, Nicor has been able to satisfactorily operate its storage fields for the last 15 years or so without the new restrictions it is now requesting. (Rosenberg, IIEC Ex. 1.0 at 17). Not only was the lack of a problem corroborated by Staff observations (*see*, Staff Br. at 104-105), it was even corroborated through the testimony and cross-examination of Mr. Bartlett himself.

Q Now, could you please turn to page 18 of your rebuttal testimony, Nicor Exhibit 19.0?

A (Bartlett) Yes, sir.

Q In the question and answer beginning on line 407 and ending on line 416, you suggest you only agree, **in part**, with Dr. Rosenberg that Nicor has been able to satisfactorily operate its storage fields *without* the restrictions you propose in this case; is that correct?

A (Bartlett) That is correct.

Q In the answer there at line 415, when you qualify your agreement with Dr. Rosenberg, you use the phrase quote, *as noted above*, unquote. Are you referring *specifically to your analysis included in Exhibit 19.3*?

A (Bartlett) I believe that would be correct.”

(Bartlett Tr. 216, *emphasis and explanation added*)

Thus, absent the discredited Nicor Exhibit 19.3<sup>9</sup>, even Mr. Bartlett agrees there are currently no operational impediments to the satisfactory operation of Nicor's storage fields that require a change to the current transportation tariff.

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<sup>9</sup> See IIEC Brief, pages 18-19, Constellation Brief pages 11-14 and Staff Brief, pages 106-107 for a thorough dissertation as to the fatal flaws of Nicor Gas Exhibit 19.3.

This leads to Nicor's second rationalization for these new MDN restrictions. Nicor states these restrictions are necessary to ameliorate the extra costs the transportation storage utilization patterns are allegedly imposing on the sales customers. As IIEC noted in its Initial Brief, this was an a posteriori rationalization, Nicor developed after it had made its proposals. (IIEC Br. at 18, Par. 1). Its sole basis is Nicor Exhibit 19.3, which has been totally discredited.

The third Nicor "reason" for the proposed restrictions is that they will somehow help to reduce the need to cap deliveries during the July through October months of the injection season. (Bartlett, Nicor Ex. 4.0-C at 25). There are two problems with this "reason". In the first place, Nicor cannot guarantee that these caps will not be needed. (Bartlett, Nicor Ex. 4.0-C at 25-26). Thus transportation customers are being requested to forego tangible and quantifiable flexibility for a hypothetical and unquantifiable "benefit". Secondly, as Mr. Sackett noted, there are not that many caps being imposed in those months. (Sackett, Staff Ex. 11.0 at 10).

The fourth Nicor "reason" for these new restrictions is that customers can nominally inject gas during the months of March and April even though the fields are in withdrawal mode. It is true that the storage fields are typically still in withdrawal mode for those two months.<sup>10</sup> IIEC also acknowledges that transportation customers may be nominally injecting in those two months, i.e. nominating more gas than they are using. Nevertheless, this situation does not necessitate the imposition of these draconian measures. Nicor is still buying gas during these months. (*see*, Bartlett, Nicor Ex. 19.3 - which assumes Nicor buys gas each day of the year). Consequently, when transportation customers nominate more gas than they use, all that implies is that Nicor is buying less gas than they would otherwise require. Nicor can still cycle its fields. In fact, Nicor

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<sup>10</sup> Although by the latter half of April, the withdrawals are greatly reduced from what they were in the winter. (*see*, Bartlett, Nicor Ex. 19.3 at 6, Col. A).

acknowledges it has “avoided degradation in the storage fields” by “greater cycling”. (Bartlett, Nicor Ex.19.0 at 18). As Staff notes, these proposed restrictions in March and April are just a more stringent reiteration of the cycling requirement in the spring that was proposed by Nicor in the last case and rejected. (*see*, Staff Br. at 111-112). Moreover, even in a worst case scenario, Nicor still has the ability to call a critical injection day and limit nominations. (*see*, Bartlett, Nicor Ex. 4.0-C at 25-26). Thus there is no need for these blanket restrictions that will hamper the flexibility of transportation customers. As the saying goes, if it isn’t broke, don’t fix it.

For all these reasons, as well as the additional reasons provided in the initial briefs of Staff, CNE, and IIEC, the Commission should summarily and totally reject the proposed new MDN restrictions.

## **2. Storage Calculations**

### **a. Storage Banking Service (“SBS”) Entitlement**

The key parameter in this storage calculation has already been established as the maximum capacity of the field, which the Commission defined as the maximum non-coincident storage capacity of Nicor’s storage fields, i.e. the sum of the maximum top working gas levels reached at each of these fields. That quantity has been established as 149.74 Bcf. Nicor concedes that this quantity is still 149.74 Bcf, but requests that the definition of capacity be changed to a new concept which it terms “operational capacity”. Nicor claims this “operational capacity” is only 134.6 Bcf (*see*, Bartlett Ex. 19.0 at 13 and Hawley, Nicor Ex. 16.0 at 9).

Now, in its Brief, Nicor claims that the numerator for the SBS entitlement should be “**the maximum amount of non-coincident on-system storage capacity that is operationally available**”. (Nicor Br. at 91). This is a term that does not appear anywhere in the record in this case or in the 2004 Rate Case Order. The reason this term does not appear in the record, is because it is

made up of whole cloth. There simply is no such thing – it is a hybrid term that has no meaning. It is like saying I will draw a square circle. The maximum amount of non coincident capacity is the sum of the maximum amount of working gas that each of Nicor’s fields has been shown capable of holding at any point in time. The amount of storage gas that is operationally available is, as the term implies, the amount of gas that Nicor plans to inject and subsequently withdraw in one year. These are two different concepts.

IIEC submits that Nicor has coined this new term, which is a conjunction of two distinct concepts in the hope that throwing in the words “maximum” and “non-coincident” and “capacity” in the same phrase will cause the Commission to think Nicor is not seeking to change the formula approved in the 2004 Rate Case for determining the SBS entitlement. The Commission should not so conclude.

One reason for the confusion is the conflicting language used by Nicor witnesses to describe this. First they characterized the denominator in the formula used to calculate the SBS charge as the amount of top gas Nicor **expects to cycle from storage**. (Mudra, Nicor Ex.14.0-C at 24). Of course this was the same way that Nicor characterized that denominator in the previous case. (*see*, 2004 Rate Case Order at 120). However, realizing the Commission rejected the use of the amount Nicor expects to cycle from storage as the appropriate denominator, and not wanting to appear as though it was requesting a change to the formula, Mr. Mudra without changing the number (134.6), stated the correct denominator was the **amount of non-coincident working gas capacity**. (Mudra, Nicor Ex.29.0-C at 39). Notice that Mr. Mudra did not use the term “maximum,” although the term capacity is meaningless if it does not imply the maximum capability of the facility being described. But now Nicor had another problem, because the maximum non-coincident capacity of the system is unquestionably 149.7 Bcf. Thus in an attempt to have their cake and eat it too, Nicor has finally

decided just to merge the two terms “maximum non-coincident working gas capacity” with the notion of “operationally available,” so that it can give the appearance of complying with the Commission’s Order in the previous case, but still use the number it wants to use. IIEC finds it ironic that Nicor is asking the Commission to reject the Staff’s proposal on this issue because, according to Nicor, “Staff incorrectly describes the Company’s formula.” (Nicor Br. at 86). IIEC submits the Staff should be forgiven for its alleged incorrect description because Nicor itself has failed to unequivocally and consistently describe its own formula.

Nicor attempts to portray this change as justifiable by implying it cannot cycle the full 149.7 Bcf. (Nicor Br. at 86-87). That may or may not be so. There is no study on the record that would demonstrate this and the evidence shows Nicor has cycled as much as 149.2 Bcf of top gas in storage in 2001-2002 in the fields and there has been no degradation in the operational capability of the fields in the last few years (Bartlett, Tr. 212-214). Regardless, it is Nicor’s storage capacity which is relevant, not its cycling plan. As the Commission noted, the correct denominator is the maximum amount of working gas that can be **stored**, and that amount is indisputably the 149.7 Bcf. (2004 Rate Case Order at 120). In fact, the Commission rejected an IIEC proposal in the 2004 Rate Case to adjust the calculation of the SBS charge because the customers purchasing SBS service were unable to fully utilize their entire entitlement. The Commission concluded the SBS charge is a capacity charge, not a usage charge, and therefore should be based on 149.74 Bcf. (*Id.* at 138-139). The 149.74 Bcf was the maximum capacity of the Nicor storage fields. (*Id.* at 106). Consistent with the Commission’s reasoning in the 2004 rate case, the 149.7 Bcf (the maximum capacity for the Nicor storage fields) should be used to calculate the SBS entitlement (and the SBS charge) in this case.

In sum, the Commission, as it did in the 2004 Rate Case, should continue to use the maximum amount of working gas that can be stored in Nicor's storage field as the numerator in the formula used to calculate SBS for transportation customers.

**b. Storage Banking Service ("SBS") Charge**

The issue here is exactly the same as in the matter of the SBS Entitlement, except that here the storage quantity is used as a denominator in the calculation of the SBS charge. IIEC submits that, for all of the reasons stated above, the Commission reject the use of the amount of "operationally available" gas that Nicor claims, and instead retain the notion of using the maximum non-coincident capacity of the fields which has been demonstrated to be 149.7 Bcf and which is fully consistent with the 2004 Rate Case Order. (2004 Rate Case Order at 120-121, 138).

**c. Storage Withdrawal Factor**

**(ii) Timing of the Storage Withdrawal Factor Calculation**

IIEC proposes that the customer's Maximum Inventory Balance be determined between the period of October 15 and November 15 as opposed to the determination occurring exactly on November 1. (IIEC Br. at 26-28). Nicor poses just two pragmatic objections to this proposal. First it claims it bills customers at the end of the month, so that the inventory balance would presumably not be known on the 15<sup>th</sup> of each month. Second, it notes that it may have to call a Critical Day on November 1<sup>st</sup>. (Nicor Br. at 89-90). As IIEC noted in its Initial Brief, these problems can be easily circumvented and are not sufficient reasons to reject this increased latitude. (IIEC Br. at 28). IIEC requests its proposal in this regard be adopted.

Staff agrees with Nicor's first objection to IIEC's proposal. Staff accepts Nicor's argument that it cannot calculate the maximum storage inventory for many transportation customers on anything other than a monthly basis because these customers do not have daily meters. (Staff Br. at

121). IIEC has suggested that if this is truly the problem, its proposal could be limited to those transportation customers who do have daily meters. (IIEC Br. at 28). Limiting the right to have the SWF calculated between October 15 and November 15 of each year to customers with daily meters would resolve Staff's concerns.

Staff also suggests that the proposal to allow trading of storage balances described in Section IX.C.5. of its brief will help users to achieve the 90% minimum storage balance requirement on November 1 of each year. (Staff Br. at 121, 124-125). IIEC appreciates Staff's suggestion, but wishes to point out that the storage balance trading proposal referenced by the Staff and agreed to by Nicor and Vanguard Energy Services ("VES"), apparently only applies to smaller transportation customers. (*see*, Staff Br. at 125). Staff does propose to modify this storage balance trading proposal to make it applicable to larger transportation customers, but the Commission's adoption of Staff's modification of the Nicor/VES proposal is not certain. If the trading service does not apply to large transportation customers, then IIEC's proposal to have the SWF for daily metered customers calculated between October 15 and November 15, should be adopted.

Furthermore, it is unclear that even if Staff's modification of the proposal to allow certain transportation customers to trade storage imbalances only one time per year (*see, Id.*) is adopted, it may not be a practical solution for transportation customers. Offering transportation customers the right to trade storage imbalances one time a year does not necessarily provide transportation customers with the flexibility they may need. For example, if a customer is required for other reasons to use its one-time per year right to trade imbalances for any other reason, the trading option will not be available to assist him in meeting the minimum storage balance requirements on November 1 of each year. Furthermore, such a customer might be required to forego the use of this annual right in order to save it for calculation of the SWF and then find its use was not necessary for

the determination of the SWF. Therefore, even if Staff's proposal to modify the storage balance trading proposal agreed to by VES and Nicor is adopted by the Commission, the Commission should still adopt IIEC's proposal for determining the SWF for daily meter transportation customers between October 15 and November 15 of each year.

## **XVII. CONCLUSION**

IIEC respectfully requests that the Commission take the actions set out below.

1. The Commission should direct modification of the Nicor ECOSS in this case to fully reflect the MDM study in the allocation of both the volume-related component and the peak-demand-related component of the Nicor mains to the Nicor rate classes.
2. The Commission should direct modification of the Nicor ECOSS, such that Nicor's storage costs are allocated to transportation customers equal to the revenue received from these customers through the cost based SBS charge.
3. The Nicor ECOSS, as modified, should be used to allocate responsibility for the Nicor revenue requirement to all rate classes and to move rates to full cost of service for each rate class.
4. In the alternative, if the Commission approves a cap on the Rate 1 increase, any associated revenue shortfall should be assigned to Rate 4 and Rate 74.
5. If the Commission is concerned about the validity of the Nicor study, then the Commission should approve an across-the-board increase for all rate classes.
6. The Commission should reject the Staff's proposal to increase the tail block for Rate 77 by 1,000 percent. The Commission should increase the Rate 77 tail block on an equal percent basis.
7. The Commission should reject Nicor's proposal to use 134.6 Bcf for the numerator in the formula used to determine the SBS entitlement and should retain the use of the maximum non-coincident capacity of 149.7 Bcf approved in Nicor Docket 04-0779.
8. The Commission should reject Nicor's proposal to use 134.6 Bcf as the denominator in the formula used to determine the SBS charge and retain the use of the maximum non-coincident capacity of 149.7 Bcf approved in Nicor Docket 04-0779.
9. The Commission should direct Nicor to modify its existing transportation service terms and conditions to establish a daily metered transportation customer's SWF on the basis of the customer's maximum storage inventory between October 15 and November 15 of each year instead of on November 1 of each year.

DATED this 9<sup>th</sup> day of January, 2009.

Respectfully submitted,

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