STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company d/b/a Nicor Gas Company	))	
	)	Docket No. 08-0363
Proposed general increase in rates, and revisions to other terms and conditions of service	)))	

REPLY BRIEF OF
NICOR GAS COMPANY

January 9, 2009

TABLE OF CONTENTS

Page

Page

Page

Page

I. INTRODUCTION / STATEMENT OF THE CASE

> *All parties should agree that Commission action brings certainty to a situation and settles expectations. This is another way of saying that unless there are clear and distinguishable reasons for deciding a case differently, the Commission will follow in line with precedent.*
>
> —*Peoples Gas Light & Coke Co.* and *North Shore Gas Co.*, Docket Nos. 07-0241 and 07-0242 (consol.), Order at 16 (Feb. 5, 2008) ("2007 Peoples Rate Case").

Certainty in regulation benefits everyone. It allows public utilities, like Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the "Company"), to make appropriate investments and to deliver essential utility services with the reasonable expectation that the regulatory foundation for their business decisions will not change underneath them. Customers likewise benefit from the utilities' resulting lower cost of capital and reduced costs of business and the improved price signals brought by consistent regulation.

A. Nicor Gas's Request for Rate Relief

The Initial Briefs confirm that Nicor Gas' current rates will not allow the Company to recover its prudently incurred 2009 test year cost of service to its customers—or even come close. Accordingly, Nicor Gas is seeking a rate increase of $140,399,000. It is a just and reasonable request intended to safeguard Nicor Gas' financial integrity and its continued ability to deliver high-quality, low-cost natural gas distribution service. If the Illinois Commerce Commission (the "Commission") were to grant the entire amount of the Company's requested rate increase in this proceeding, Nicor Gas still would have the lowest rates among Illinois' major gas utilities. Hawley Dir., Nicor Gas Ex. 1.0, 8:155-60.

Nicor Gas' case finds strong support in recent Commission Orders. In contrast, Staff and the Office of the Illinois Attorney General (the "AG") and the Citizens Utility Board ("CUB") (collectively, "AG/CUB") propose slashing the Company's revenue requirement based upon adjustments that the Commission previously has rejected or that are inconsistent with recent Commission Orders. Most notably, Staff and AG/CUB propose a hypothetical capital structure for Nicor Gas, with a large short-term debt component. The Commission has rejected similar proposals to impute short-term debt into Nicor Gas' capital structure in each of Nicor Gas' last three rate cases, Docket Nos. 04-0779, 95-0219 and 87-0032 ("2004 Rate Case," "1995 Rate Case" and "1987 Rate Case," respectively).[1] Additionally, Staff asks the Commission to employ an *ad hoc* methodology for calculating Nicor Gas' fair return on common equity ("ROE"), which Staff admits the Commission previously has not seen or approved. Meanwhile, AG/CUB propose an ROE methodology that the Commission repeatedly has rejected. Staff and the AG also propose an adjustment to the cash working capital ("CWC") component of Nicor Gas' rate base that the Commission rejected twice last year.

Certainty in regulation is no luxury. Nicor Gas historically has been a financially strong utility, and its customers have benefited from stable regulation and sound financial management. It is essential that the Commission maintain the financial stability of Nicor Gas and other Illinois utilities during this period of historic economic turmoil, so that they can withstand financial setbacks without jeopardizing their liquidity and access to the capital markets upon reasonable terms. Fetter Dir., Nicor Gas Ex. 2.0, 6:122-34. The consequences of inadequate rate relief are stark: As Nicor Gas Executive Vice President and Chief Financial Officer Hawley testified: "When it does not have a fair opportunity to recover its costs, both the Company and its customers lose." Hawley Dir., Nicor Gas Ex. 1.0, 6:110-11.

[1] For the Commission's convenience, Nicor Gas uses the same defined references to prior Commission decisions, and other defined terms, in this Reply Brief as employed in its Initial Brief.

B. Staff and AG/CUB's Proposed Adjustments

As detailed in its Initial Brief, Nicor Gas relied wherever possible on recent Orders for guidance, including the Commission's 2004 Rate Case Order, which should provide a roadmap in this proceeding. In contrast, Staff's and AG/CUB's most significant adjustments find no Commission support. AG/CUB's results-oriented approach is transparent. On direct, AG/CUB proposed an increase in Nicor Gas' revenue requirement of $54,590,000. Effron Dir., AG/CUB Ex. 1.1. On rebuttal, AG/CUB adopted Staff's improper capital structure proposal, without any independent analysis, and reduced their revenue requirement proposal to $50,297,000. Effron Reb., AG/CUB Ex. 4.16. Now, in their Initial Briefs, AG/CUB include and adopt a grab bag of Staff adjustments for the first time to reach a new and reduced $42,998,000 revenue requirement proposal. AG Init. Br. at Sch. A.

The Commission has spoken unambiguously on the short-term debt issue. "The key determination on whether short-term debt is included or excluded from the capital structure is the *purpose* of the short-term debt." 2004 Rate Case, Order at 71 (original emphasis). In its Initial Brief, Staff conspicuously omits any reference to this unambiguous standard or to the Commission's exclusion of short-term debt from Nicor Gas' capital structure in each of the Company's last three rate cases. 2004 Rate Case, Order at 69-72; 1995 Rate Case, Order at 37; 1987 Rate Case, Order at 20-27. Nicor Gas' proposed capital structure does *not* include short-term debt, because Nicor Gas does *not* use short-term debt to finance rate base assets. Ruschau Reb., Nicor Gas Ex. 24.0, 8:178-9:189. Accordingly, the Commission should adopt the Company's proposed capital structure of 56.77% common equity, 0.12% preferred stock, and 43.11% long-term debt. Nicor Gas Init. Br. at 45-48; Ruschau Reb., Nicor Gas Ex. 24.0, 4:98-99; Nicor Gas Ex. 24.1.

Nicor Gas recommends, and the Commission should adopt, an 11.15% fair ROE in this proceeding. Makholm Reb. Corr., Nicor Gas Ex. 25.1. Nicor Gas developed and presented its ROE proposal using the same proven calculation methodology employed in the Company's 2004 Rate Case. Nicor Gas Init. Br. at 54-55; 2004 Nicor Gas Rate Case, Order at 86-88. Breaking sharply with that template, Staff and CUB here each pursue, at best, unproven methodologies that result in unreasonably low proposed ROEs (9.68% and 9.455%, respectively) and inadequate overall rates of return. Ruschau Sur., Nicor Gas Ex. 43.0, 3:49-52; Staff Init. Br. at 47-53; CUB Init. Br. at 14-27. Now is not the time to experiment with unproven ROE methods. Staff's and CUB's proposed ROEs are far below the fair ROEs determined by the Commission in other recent major rate proceedings. Nicor Gas Init. Br. at 54, Fig. 3. Nicor Gas' ability to compete for equity capital is an important consideration given the increased risk in U.S. and global financial markets. Fetter Sur., Nicor Gas Ex. 36.0, 3:60-4:68.

Similarly, Staff's proposed $25,010,000 downward adjustment to rate base, based on its CWC proposal, is unreasonable. Staff unsuccessfully proposed the same treatment of pass-through taxes in the recently decided 2007 Peoples Rate Case, Order at 22, and in the Ameren Illinois utilities rate cases, Docket Nos. 07-0585 *et al*. (consol.), Order at 62 (Sep. 24, 2008) ("2007 Ameren Rate Case"). Nothing in Staff's Initial Brief warrants a different approach or outcome in this proceeding.

The record is clear, Nicor Gas developed its revenue requirement proposal relying on prior Commission Orders. Conversely, Staff's and AG/CUB's largest adjustments conflict with these decisions. As the Commission has stated: "Commission action brings certainty to a situation and settles expectations." 2007 Peoples Rate Case, Order at 16. Staff and AG/CUB offer no reasonable basis to abandon these prior Orders and create unnecessary and harmful regulatory uncertainty. Accordingly, the Commission should reaffirm its commitment to assuring regulatory certainty and reject Staff's and AG/CUB's unsupported adjustments.

C. Nicor Gas' Rate Design and Cost-Recovery Riders

Nicor Gas' Initial Brief shows that its proposed revenue allocation is appropriate, equitable, and just and reasonable. Nicor Gas Init. Br. at 60-66. The Company's ECOSS is consistent with the one approved in the 2004 Rate Case. It allocates the revenue requirement on an equitable basis and moderates the increase allocated to residential customers. Staff agrees with the Company's revenue allocation proposal. Staff. Init. Br. at 71. The Company also proposes to increase the Rate 1 residential customer class Monthly Customer Charge to recover a greater percentage of its fixed costs through the fixed monthly charge and to reduce the number of distribution blocks from three to two. Nicor Gas Init. Br. 68-75. This approach is consistent with recent Commission Orders. *Id*. In contrast, Staff and AG/CUB pursue rate design approaches that unreasonably move away from recovering fixed costs through fixed charges. Staff Init. Br. at 78-92; AG Init. Br. 20-25.

Finally, Nicor Gas proposes five new cost recovery riders: Rider UEA (Uncollectible Expense Adjustment), Rider CUA (Company Use Adjustment), Ride VBA (Volume Balancing Adjustment), Rider EEP (Energy Efficiency Plan), and Rider QIP (Qualifying Infrastructure Plan). In their Initial Briefs, Staff and AG/CUB claim that these riders are either outside the Commission's authority and may not be approved or are contrary to ratemaking principles and should not be approved. These arguments contradict the Commission's recent affirmation of its rider authority in approving riders similar, if not substantively identical, to four of the five riders proposed by Nicor Gas. *See* 2007 Peoples Rate Case, Order at 138-53, 183-84; *Commonwealth Edison Company*, Docket No. 07-0566, Order at 103, 137-38 (Sep. 10, 2008) ("2007 ComEd

Rate Case"). Accordingly, the Commission should approve Nicor Gas' proposed new cost-recovery riders.

II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY

Nicor Gas incorporates herein the discussion of Overall Revenue Requirement and Revenue Deficiency from Section II of its Initial Brief.

III. TEST YEAR

Nicor Gas incorporates herein the discussion of Test Year from Section III of its Initial Brief.

IV. RATE BASE

A. Overview

Nicor Gas incorporates herein the discussion of Rate Base Overview from Subsection IV.A of its Initial Brief.

B. Uncontested Issues

1. Northern Region Reporting Center ("NRRC")

Nicor Gas and Staff agree that the NRRC should be included in rate base at a cost of $5.9 million. Nicor Gas Init. Br. at 10; Staff Init. Br. at 3.

In its Initial Brief, the AG recommends for the first time that the NRRC and Central Distribution Center and Meter Shop ("CDC") be removed from rate base, based on testimony from Staff witness Maple. AG Init. Br. at 12. The AG presented no independent evidence on this issue. The AG, however, fails to recognize that Staff now supports the inclusion of the NRRC in rate base at a cost of $5.9 million. Staff Init. Br. at 3. The AG further fails to recognize that the Company withdrew its request for the CDC in surrebuttal testimony, and the associated costs are not included in Nicor Gas' rate base request. D'Alessandro Sur., Nicor Gas Ex. 37.0, 10:234-11:241. Given that the AG has presented no evidence concerning the NRRC, and depends entirely upon an outdated Staff position, the AG's recommendation should be rejected.

2. Plant Additions – Original Cost Determination

Nicor Gas incorporates herein the discussion of Plant Additions – Original Cost Determination from Subsection IV.B.2 of its Initial Brief.

C. Contested Issues

1. Cash Working Capital ("CWC")

Despite the Commission having rejected Staff's same proposed CWC adjustment in the 2007 Peoples Rate Case and the 2007 Ameren Rate Case last year, Staff continues to propose the identical CWC adjustment in this proceeding. Staff Init. Br. at 4-9; 2007 Peoples Rate Case, Order at 22; *Ameren Utilities*, Docket Nos. 07-0585 *et. al.* (consol.), Order at 62 (Sep. 24, 2008) ("2007 Ameren Rate Case"). In the 2007 Peoples Rate Case, the Commission invited Staff to present additional evidence in future proceedings to support its claims. 2007 Peoples Rate Case, Order at 22. Staff failed to do so in the subsequent 2007 Ameren Rate Case, as the Commission rejected Staff's proposal again. 2007 Ameren Rate Case, Order at 62. Meanwhile, Staff claims that it now has presented additional information. Staff Init. Br. at 8-9. However, Nicor Gas demonstrated that Staff only has repackaged the same, twice-rejected claims. Adams Sur., Nicor Gas Ex. 42.0, 3:48-9:178. There simply is no reasonable basis, and Staff offers none, for the Commission to reverse course from its recent rulings on this issue.

Nicor Gas demonstrated through its evidentiary presentation that it is reasonable to include a CWC allowance in the Company's rate base. Nicor Gas Init. Br. at 11-17. The CWC allowance was determined based upon a thorough analysis of the timing of the Company's cash receipts and cash expenses. Nicor Gas employed the same analysis for CWC that the Commission approved in the 2007 Peoples Gas and 2007 Ameren Rate Case. *Id*. at 11.

For the most part, Staff and the Company are in agreement with regards to the CWC analysis. The points of disagreement continue to be (1) Staff's proposed treatment of pass-through taxes, and (2) whether the CWC analysis reflected a balancing of the level of cash operating revenues and expenses.[2] These are the same Staff proposals that the Commission twice rejected in 2008. As demonstrated below, the Commission should continue to reject Staff's, and now the AG's, positions on these issues.

(a) Inclusion of Pass-Through Taxes at Zero Revenue Lag Days

Staff continues to argue that the inclusion of pass-through taxes in the CWC analysis, with zero revenue lag days, is proper. Staff Init. Br. at 4-9. The Company's revenue lag consists of a service period, billing period, collection period and payment processing period. Staff does not dispute the components of the revenue lag. The resulting revenue lag was determined to be 50.81 days. Adams Reb., Nicor Gas Ex. 23.0, 2:35-4:65. The Company and Staff both agree on the revenue lag for all revenues besides those associated with pass-through taxes. Nicor Gas Init. Br. at 12. The Company applies the 50.81 days of revenue lag to the pass-through taxes, consistent with all other revenues, as pass-through taxes are collected from its customers via the only source of revenues—the customers' payment of the monthly bill. Staff argues that there is no revenue lag for pass-through taxes, but fails to identify an alternative method by which it believes the pass-through taxes are collected from the Company's customers. Indeed, Staff offers no new or unique information that would somehow overcome the fact that its position has been rejected on two occasions. Adams Sur., Nicor Gas Ex. 42.0, 3:48-9:178.

[2] The AG presented no testimony on this issue during the proceeding. Now, for the first time in its Initial Brief, the AG supports Staff's proposed adjustment. AG Init. Br. at 9. Interestingly, the AG did not express support for Staff's same adjustments in either the 2007 Ameren Rate Case or the 2007 Peoples Rate Case. For the reasons set forth herein, the AG's position should be rejected.

The Company's CWC analysis reflects the *actual elapsed time* between the collection of the customers' payments and the remittance of the pass-through taxes to the appropriate taxing authority. Conversely, Staff's position is based upon an unsubstantiated belief that the Company collects funds, via an unidentified source or process, and then holds the funds associated with the pass-through taxes for in excess of a month prior to remitting the funds to the appropriate taxing authority. Staff performed no analysis to support its position, but instead, relies solely upon its misinterpretation of a few data request responses and other ill-founded beliefs (which the Commission has repeatedly rejected) to support its proposed adjustment.

Staff contends that such an adjustment is appropriate because "1) in the context of a rate case, pass-through taxes are not operating revenues, and therefore cannot have a revenue lag; and 2) ratepayers provide pass-through taxes for the Company to hold and later remit to taxing bodies." Staff Init. Br. at 4. Neither claim is correct.

Contrary to Staff's claim, pass-through taxes are operating revenues recorded by the Company. Gorenz Dir., Nicor Gas Ex. 11.0, 23:500-10; Nicor Gas Ex. 11.1, Schs. C-1 and C-2; Adams Sur., Nicor Gas Ex. 42.0, 4:62-63. The Company collects pass-through taxes in the same manner and at the same time that it collects all other payments from its customers—through monthly bill payments. Indeed, the Commission recognized this fact in both its 2007 Peoples Rate Case Order and the 2007 Ameren Rate Case Order. 2007 Peoples Rate Case, Order at 22; 2007 Ameren Rate Case, Order at 62.

Recognizing this erroneous claim, Staff now asserts that it meant to say that pass-through taxes are not operating revenues, which are considered when setting base rates. Staff's attempt to re-engineer its position does not change how pass-through taxes should be treated in the CWC analysis. The Company correctly excluded such pass-through taxes from both operating revenues and expenses for purposes of setting base rates. Adams Sur., Nicor Gas Ex. 42.0, 4:65-71. The mere exclusion of the pass-through taxes from base rates, however, does not mean that they should be excluded from the CWC analysis. For example, gas supply costs also are not collected through base rates, but are reflected in the CWC analysis. *Id.*, 6:102-10. Notably, Staff acknowledges this point and does not propose to exclude gas supply dollars from the CWC analysis.

To sidestep its inconsistent position, Staff argues that gas costs are related to the service the Company provides to ratepayers while pass-through taxes are not part of a service provided to customers. Kahle Reb., Staff Ex. 14.0, 8:170-72. Once again, Staff's position is irrevocably flawed. Pass-through taxes are directly related to the customers' consumption of natural gas. Accordingly, delivering natural gas for consumption and the resulting generation of pass-through taxes are integrally linked. Adams Sur., Nicor Gas Ex. 42.0, 5:87-90. Therefore, the distinction which Staff attempts to draw between the inclusion of gas costs and pass-through taxes in the CWC analysis is without merit.

Staff's second argument in support of its position on pass-through taxes also is erroneous. Based solely upon its flawed interpretation of certain data request responses, Staff concludes that the Company collects from its customers the funds associated with the pass-through taxes and holds such funds for an extended period of time until such time as the funds are remitted to the appropriately taxing authorities. Nicor Gas witness Adams explained that Staff's interpretation and resulting conclusion are erroneous. Adams Sur., Nicor Gas Ex. 42.0, 7:130-8:150.

The Company's CWC analysis reflects the actual timing related to the provisioning of services which generate the Company's operating revenues (including the pass-through taxes), the billing to the customer for such services, the collection period during which the funds are received, processed and made available to the Company in its bank accounts. Adams Dir., Nicor Gas Ex. 8.0, 18:370-20:413. The Company's CWC analysis also accurately reflects the timing of the receipt of goods and services provided to the Company, the billing and payment for such services and the elapsed time before such funds leave the Company's bank accounts. *Id*. Staff has provided no evidence that the Company's CWC analysis is incorrect.

There can be no argument that the Company bills its customers for its services (including pass-through taxes) and later receives payment from its customers for the services via a single payment. Under Staff's proposed adjustment, Staff suggests that the funds associated with pass-through taxes are treated differently than other revenues which are included on the customers' bills. The timing of the receipt of the dollars associated with the pass-through taxes cannot be different than the other revenues reflected in the CWC analysis. There is only one source via which the Company receives payment for the services which the Company offers, and that source is the monthly bill. Adams Sur., Nicor Gas Ex. 42.0, 5:95-97. Staff acknowledges this fact. Kahle Reb., Staff Ex. 14.0, 6:119-21. Therefore, no timing difference can exist, as proposed by Staff, between the pass-through taxes and all other operating revenues.

The Company's CWC analysis accurately reflects the timing of the billing and payment of the customers' monthly bill. Staff offers no opposition to the Company's CWC analysis as it relates to the preparation and mailing of the monthly bills, or to the timing of the receipt of the customers' payment. Staff further concurs that the monthly bill is the sole source of customer payments. Kahle Reb., Staff Ex. 14.0, 6:119-21. Therefore, it is perplexing how Staff concludes that the pass-through taxes are unique and should be treated differently than other customer payments.

In its Initial Brief, Staff alleges that "Mr. Adams also misrepresents the timing of the cash flows for pass-through taxes which makes it appear that the Company holds the cash for a much shorter time than it actually does." Staff Init. Br. at 7. Setting aside the absurdity of such an allegation, Staff once again relies solely on its interpretation of a few data requests to support such allegations. A review of the Appendices to the Commission's Final Orders in the 2007 Peoples Rate Case and the 2007 Ameren Rate Case fails to support Staff's interpretation of the data request responses.

Staff purports that the Company collects the revenues associated with pass-through taxes in one month, and then remits the funds in the following month. Kahle Dir., Staff Ex. 1.0, at 9-11. While the timing of Peoples Gas' and Ameren's pass-through taxes vary from that of Nicor Gas, the identical taxes are collected and remitted in a similar manner per the directives of the various taxing authorities. A review of the 2007 Peoples Rate Case Order shows that Peoples revenue lag was 49.44 days. 2007 Peoples Rate Case, Order at App. A at 10. The expense leads for the pass-through taxes are shown on the same appendix. *Id.* at 13. With the exception of one pass-through tax (the Gross Receipts/Municipal Use Tax), Peoples remits payment for the pass-through taxes prior to receipt of payment from its customers. The elapsed times between the payment of Peoples Gas' monthly bill and the remittance of the pass-through taxes to the appropriate taxing authorities are similar, in total, to that of Nicor Gas. In no case did Peoples Gas nor does Nicor Gas collect funds one month and remit the funds the following month.

According to the 2007 Ameren Rate Case Order, Ameren had a revenue lag of 25.74 days for pass-through taxes. 2007 Ameren Rate Case, Order at App. F at 6. With the exception of the Municipal Utility Tax ("MUT") and the Energy Assistance Tax, AmerenIP remitted payment of the pass-through taxes prior to receipt of payment from its customers. AmerenIP's expense lead days for the MUT was 30.415 days or slightly less than five days after the receipt of the customers' payment of the monthly bill, while the Energy Assistance Tax was paid approximately two days after the receipt of the customers' payment. Nicor Gas' CWC analysis shows actual experiences similar to those of Peoples Gas and Ameren.

Staff has failed to support its position that the revenue lag applied to the pass-through taxes should be zero days. The Company bills and collects such taxes via the monthly billings to its customers. The Commission recently has considered and rejected Staff's identical arguments. Staff has offered no new evidence in this proceeding to warrant a change from the Commission's previous decisions on this matter. Accordingly, the revenue lag applied to the pass-through taxes should be the same as the revenue lag applied to all other operating revenues.

(b) Balancing of Revenues and Expenses

Staff did not address the issue of the need to balance the level of revenues and expenses in the CWC analysis in its Brief. Accordingly, Nicor Gas urges the Commission to adopt its position, as set forth in its Initial Brief. Nicor Gas Init. Br. at 16-17.

2. Gas in Storage

Through its evidentiary presentation and Initial Brief, Nicor Gas demonstrated that its Gas in Storage test year balance of $95,645,000 is prudent and reasonable. Nicor Gas Init. Br. at 17-20. Staff has no objection to the Company's proposed Gas in Storage Balance. Staff Init. Br. at 9.

AG/CUB's adjustment focuses solely on the volume of Gas in Storage. They erroneously claim that the volume of gas used to calculate the Company's Gas in Storage balance is too large and should be reduced, resulting in an almost 31% reduction to the Gas in Storage balance, or $29,228,000. AG Init. Br. at 9-10; CUB Init. Br. at 4-5. AG/CUB's claim should be rejected for a number of reasons. First, Nicor Gas developed its Gas in Storage balance in a manner consistent with past Commission practice, including the Company's last two rate cases (Docket No. 04-0779 and Docket No. 95-0219). Gorenz Dir., Nicor Gas Ex. 11.0, 15:321, 15:326-35. Using this approach, the Company's actual 2008 storage levels, as of October 31, 2008, were at a level consistent with or above the original 2008 forecast: again demonstrating the validity of the Company's methodology. AG Cross Ex. 11; Tr. at 285:11-14. The Initial Briefs of both the AG and CUB are silent on this point. In addition, neither the AG nor CUB addresses the fact that the Company used a methodology consistent with Commission practice, and AG/CUB witness Effron failed to address this point in his testimony. *See* AG Init. Br. at 9-10; CUB Init. Br. at 4-5; Effron Dir., AG/CUB Ex. 1.0; Effron Reb., AG/CUB Ex. 4.0. Given that the AG and CUB fail to provide any justification, let alone a reasonable justification, for discarding a methodology for calculating the Company's Gas in Storage balance that is consistent with past Commission practice, AG/CUB's proposed adjustment should be rejected.

Second, this adjustment is premised upon AG/CUB witness Effron's improper approach for developing his Gas in Storage figure. Effron Reb., AG/CUB Ex. 4.0, 3:20-4:11. Nicor Gas witness Bartlett, who, unlike Mr. Effron, has extensive experience in gas storage operations, explained that Mr. Effron's approach fails to recognize that storage operations are cyclical; fields must be filled and emptied each year. Bartlett Sur., Nicor Gas Ex. 38.0, 4:94-7:160. Consequently, Mr. Effron's selective use of certain 2007 and 2008 month-end storage balances, rather than information from other recent calendar years, does not provide more precision in predicting 2009 storage balances. *Id.*

Third, Nicor Gas' forecast for month-end volumes is based on normal weather conditions, a prudent and reasonable injection and withdrawal plan for storage gas, and reasonable assumptions concerning storage field activity (including Transportation Customer usage). *Id.*, 7:161-78. None of these key components of the forecasted test year month-end volumes are considered in Mr. Effron's approach, nor did the AG or CUB contest these facts. Their respective Initial Briefs are silent on this point, too.

Finally, Nicor Gas demonstrated that its 2009 forecast of month-end working gas in storage volumes is comparable to both a three- and four-year average of actual storage volumes. Bartlett Reb., Nicor Gas Ex. 19.0, 3:77-7:161; Bartlett Sur., Nicor Gas. Ex. 38.0, 3:78-9:199; Nicor Gas Ex. 38.1. In particular, this comparison shows that using actual volumes for the most recent three-year period, ending with December 2007, and using test year gas prices, results in a gas in storage component of $90,448,115. Applying the same analysis over a four-year period, also ending with December 2007, results in a gas in storage component of $97,916,836. Bartlett Sur., Nicor Gas Ex. 38.0, 8:174-86; Nicor Gas Ex. 38.1. Meanwhile, the Company's 2009 Gas in Storage balance is $95,645,000, which falls between the results of the Company's three- and four-year analyses. Clearly, this comparison further serves to demonstrate that the Company's 2009 forecast of working gas in storage month-end volumes is reasonable.

For these reasons, the Commission should reject the AG/CUB proposal to improperly reduce the 2009 forecasted volume of working gas in storage.

3. Pension Asset

Nicor Gas proposes including in rate base $142,044,000 related to its net pension asset. Gorenz Reb., Nicor Gas Ex. 26.2, Sch. 8. Staff and AG/CUB each propose to remove the pension asset from rate base, based upon the Commission's decisions in earlier rate cases. Staff Init. Br. at 9-13; AG Init. Br. at 10-12; CUB Init. Br. at 5-6. Nicor Gas acknowledges the Commission's prior decisions on this issue and recognizes the significance of those prior decisions for this case absent a change in direction by the Commission. However, Nicor Gas also is aware that there are open questions relating to pension asset issues, which arise from

ComEd's pending appeal from its 2005 rate case (Docket No. 05-0597). In order to preserve its rights based on the outcome of the ComEd appeal, the Company has included the pension asset in rate base here. Nicor Gas Init. Br. at 20.

4. Gross Plant

The evidence demonstrates that Staff's proposal to reduce Gross Plant by 2.87% for both 2008 and 2009 would reduce Gross Plant unreasonably and should be rejected for a number of reasons.[3] Staff Init. Br. at 14-17. For 2008, Nicor Gas demonstrated that through October 31, 2008, the Company's actual 2008 capital expenditures are $2,635,100 over budget. Staff Cross Ex. 3, Nicor Gas Supp. Resp. to AG (DJE) DR 8.07. Staff did not, and cannot, refute this fact. Indeed, Staff's Initial Brief fails to acknowledge that the Company's actual capital expenditures for 2008 exceed budget through October 31, 2008. Staff Init. Br. at 14-17. Given that actual capital expenditures exceed budget for the first ten months of 2008, there is no reasonable basis to reduce 2008 Gross Plant by any amount, let alone the 2.87% that Staff proposes.

For 2009, Nicor Gas also demonstrated that its Gross Plant balance is reasonable and should be accepted. Nicor Gas Init. Br. at 21-22. The evidence demonstrates that Staff witness Ostrander incorrectly used mismatched data when conducting his four-year analysis of historical actual to budget variances. *Id*. In particular, Mr. Ostrander used a mid-year capital expenditure forecast rather than an original capital expenditure budget for 2004, when comparing to 2004 actual capital expenditures. D'Alessandro Sur., Nicor Gas Ex. 37.0, 12:274-13:290. Staff did not, and cannot, refute this fact. Instead, Staff claims that it used, and the Commission relied upon, the mid-year forecast in the 2004 Rate Case. Staff Init. Br. at 15. Staff's claim is

[3] AG/CUB witness Effron withdrew a proposed adjustment to Gross Plant in his testimony, recognizing that such adjustment was a double count to his proposed adjustment to the Accumulated Reserve for Depreciation and Amortization. The AG, however, now adopts for the first time in its Initial Brief Staff's proposed adjustment. AG Init. Br. at 12. This proposal should be rejected for the reasons set forth herein.

unavailing. The mid-year capital expenditure forecast provided to Staff in the 2004 Rate Case was presented in the context of that proceeding, and was comprised of a test year using three months actual and nine months forecasted information. Staff does not address this fact in its Initial Brief. Avoiding the apples-to-oranges comparison of a mixed actual forecast for 2004 and instead using the proper 12 months budgeted data for 2004 has a dramatically different result under Mr. Ostrander's proposed four-year analysis of historical actual to budget variances, reducing the variance from Staff's claimed 2.87% to 0.52%. D'Alessandro Sur., Nicor Gas Ex. 37.0, 12:274-13:290. Accordingly, Staff's use of mismatched data to support its adjustment should be rejected.

Meanwhile, Staff's use of a four-year period to analyze variances is likewise unsound. Staff asserts that its use of that time period is consistent with the four-year period used for its original cost determination, but offers nothing more. Staff Init. Br. at 15. The Company demonstrated that simply by adding one year to the analysis, Nicor Gas' average annual capital expenditures were 1.60% *over* budget during that five-year period, confirming that no downward adjustment to the Company's proposed 2009 Gross Plant is warranted. D'Alessandro Sur., Nicor Gas Ex. 37.0, 13:291-97.

Not to be deterred, Staff presents for the first time a five-year analysis in its Initial Brief. Staff Init. Br. at 16. While Staff continues to employ the use of non-comparable and inconsistent data for 2004, their five-year analysis results in a variance of less than 1%, or 0.70%. *Id.* This result further serves to confirm that, despite Staff's use of incorrect data, the Company's budget of capital expenditures has been remarkably accurate and its test year Gross Plant figure should be included in rate base.

The evidence demonstrates that no downward adjustment to the Company's 2008 and 2009 Gross Plant is warranted. For 2008, actual capital expenditures exceed budget for the first ten months of the year. That evidence alone demonstrates that no adjustment for 2008 is warranted. Meanwhile, the Company showed that when using correct data in a historical analysis of budgeted to actual annual capital expenditures, Nicor Gas' budgeting is remarkably accurate. If, however, the Commission somehow determines that an adjustment to 2009 Gross Plant is necessary, it should be limited to 0.52%, which is the result when using the correct data in Staff's four-year analysis.

5. Accumulated Reserve for Depreciation and Amortization

(a) AG/CUB's Proposed Reduction in Net Removal Costs Conflicts with the Evidence Demonstrating that the Company's 2008 Costs are in Line with Budget

AG/CUB's proposed reduction to the Company's net removal costs for both 2008 and 2009 is premised on their erroneous attempt to annualize net removal costs, based upon actual 2008 data through September 30, 2008, and comparing that annualized amount to the Company's 2008 and 2009 budgets. AG Init. Br. at 13; CUB Init. Br. at 7. AG/CUB rely on the testimony of AG/CUB witness Effron for this adjustment. *Id.* The evidence demonstrates that Mr. Effron's adjustment for both 2008 and 2009 is unreasonable and should be rejected.

Mr. Effron's adjustment for 2008 should be rejected for several reasons. First, Mr. Effron's proposed adjustment for 2008 fails to consider the $1,358,000 transfer of certain plant to non-utility property in 2008. Mr. Effron's error results in a misstatement of the Company's 2008 budgeted net removal costs, and a corresponding overstatement of his proposed adjustment. Gorenz Sur., Nicor Gas Ex. 45.0, 15:325-32. This oversight inflates his adjustment by $1,358,000. *Id*. Neither the AG nor CUB address this flaw in their briefs.

Second, Mr. Effron's proposed adjustment fails to consider the fact that the Company does not expend removal costs evenly throughout the year. Mr. Effron's estimate of 2008 and 2009 net removal costs does nothing more than annualize actual expenditures through September 30, 2008. Such conjecture ignores the Company's monthly spending patterns in 2006 and 2007, whereby it expended an average of 35% of its annual net removal cost budget in the fourth quarter—not the 25% he suggests. The Company does not incur these costs on an equal rate from month-to-month. Gorenz Sur., Nicor Gas Ex. 45.0, 16:335-37. Instead, Nicor Gas incurs a substantial portion of the expense in the last quarter of the year, and expects to incur about one-third of its budgeted net removal costs in the fourth quarter of 2008. *Id*., 16:337-42. Again, is consistent with its fourth quarter spend in 2006 and 2007. *Id*. The AG ignores this evidence in its Initial Brief.

Third, AG/CUB conveniently ignores evidence of actual net removal cost data after September 30, 2008. The Company's data through October 31, 2008 discredits Mr. Effron's position. The Company's actual 2008 net removal costs through October 31, 2008 closely approximate budget and, in fact, are within $539,000 of such budget. Staff Cross Ex. 3, Nicor Gas Supp. Resp. to AG (DJE) DR 8.07. Consequently, there is no reasonable basis to reduce net removal costs for 2008, when the most current actual data in the record demonstrates that expenditures approximate the budget.

Nicor Gas also demonstrated that Mr. Effron's use of 2008 data to adjust 2009 net removal costs is flawed. Gorenz Sur., Nicor Gas Ex. 45.0, 16:349-50. Moreover, given the accuracy of the Company's capital budget forecasts, of which net removal costs are a component, AG/CUB's proposed disallowance for 2009 is unreasonable. Nicor Gas Init. Br. at 23-24.

In conclusion, the Commission should reject AG/CUB's proposed reduction in net removal costs for both 2008 and 2009. Actual 2008 net removal costs are on budget through October 2008. Meanwhile, the Company demonstrated that its forecasted 2009 net removal costs are reasonable. Accordingly, the Commission should adopt Nicor Gas' proposed net removal costs for the test year.

(b) No Party Presented Evidence Proposing the Disallowance of 2008 and 2009 Costs for the Company's Main Replacement Program

Nicor Gas presented evidence demonstrating why its main replacement program for 2008 and 2009 was prudent and reasonable. Neither Staff nor any party presented any evidence proposing a disallowance related to this program for 2008 or 2009.

In its Initial Brief, Staff incorrectly claims, in the context of a test year rate base adjustment, that Staff and AG/CUB object to the main replacement program. Staff Init. Br. at 17. That claim is wrong. Neither Staff nor AG/CUB propose any rate base adjustment related to 2008 and 2009 investments made pursuant to the main replacement program. *See* Kahle Reb., Staff Ex. 14.0; Effron Reb., AG/CUB Ex. 4.0. In reality, Staff's and AG/CUB's testimony addresses only the Company's proposed Rider QIP. Anderson Dir., Staff Ex. 9.0, 4:58-8:153; Rubin Dir., AG/CUB Ex. 2.0, 29:649-38:846. Absent any evidence objecting to 2008 or 2009 capital expenditures relating to the main replacement program, the Commission should find that such expenditures are prudent and reasonable.

V. OPERATING EXPENSES

A. Overview

Nicor Gas incorporates herein the Overview discussion from Subsection V.A of its Initial Brief.

B. Uncontested Issues

Nicor Gas incorporates herein the discussion of Uncontested Issues from Subsections V.B.1-9 of its Initial Brief.

C. Contested Issues

1. Incentive Compensation Costs and Expenses

Staff objects to Nicor Gas' recovery of costs attributable to its ICU Plan, claiming that current ratepayers do not benefit from the ICU Plan, and that "ICU test year expense is calculated solely based upon the net increase in retained earnings per share." Staff Init. Br. at 22 *citing* Staff Cross Ex. 3; DLH-13.02, Ex. 1 at 7, Ex. 2. The AG now joins in Staff's objection. AG Initial Br. at 14. Staff's position should be rejected, because it misapplies prior Commission Orders and mischaracterizes the manner in which the ICU Plan operated. Moreover, Staff's position continues to disregard the fact that the Commission repeatedly has included the costs of the ICU Plan in prior rate case proceedings.

Staff's reliance on various Commission Orders addressing incentive compensation plans and their attendant benefits to customers is misplaced. Staff overlooks a number of critical distinctions between the ICU Plan and the incentive compensation plans previously addressed by the Commission. In each of the Commission Orders upon which Staff relies, the incentive compensation plans under consideration were active. In contrast, the Company's ICU Plan is inactive, and has been since 1980. Bacidore Sur. Corr., Nicor Gas Ex. 41.0, 2:33-35.

None of Staff's cited Orders involves expenses resulting from a discontinued incentive compensation plan. This distinction is important, because while the Commission repeatedly has addressed the standards for cost recovery for ongoing incentive compensation plans, it never has applied the same standards to plans no longer in effect. In its Order in the 2004 Rate Case, the Commission, in evaluating the Company's ongoing incentive compensation plans, stated the general principle that incentive compensation plans must demonstrate benefits to ratepayers, yet it tacitly approved the same ICU Plan costs at issue in this case. *Id*. at 3:59-62. The Company acknowledges that the Commission did not explicitly discuss the ICU Plan expenses in the 2004 Rate Case. Rather, neither Staff nor any party opposed the ICU Plan costs requested in that proceeding.

Moreover, the Commission always has approved ICU Plan costs in rate cases dating back for decades. Bacidore Sur. Corr., Nicor Gas Ex. 41.0, 2:33-35; *see* 2004 Rate Case; 1995 Rate Case; 1987 Rate Case. Staff does not, and cannot, refute this point. The Commission's previous approval of the ICU Plan costs cannot be reconciled by Staff's unstated premise in this proceeding that the standards cited for cost recovery for ongoing incentive compensation plans apply to the Company's ICU Plan as well.

Further, in attempting to apply an incorrect standard, Staff claims that "ICU test year expense is calculated solely based upon the net increase in retained earnings per share." Staff Init. Br. at 22 *citing* Staff Cross Ex. 3, DLH-13.02, Ex. 1 at 7, Ex. 2. In each of the plans discussed in Staff's cited Commission Orders, the proposed incentive compensation was paid based on the achievement of specified incentive compensation goals. 2004 Rate Case, Order at 42-46; *Ill. Power Co.*, Docket No. 93-0183, Order, 1994 WL 175123 at 72-73 (Apr. 6, 1994); *MidAmerican Energy Co.*, Docket No. 99-0534, Order, 2000 WL 344446650 at 10-11 (Jul. 11, 2000); *AmerenCIPS*, Docket No. 00-0802, Order, 2001 WL 1772220 at 22-25 (Dec. 11, 2001); *Ameren DST*, Docket No. 06-0070 *et. al.* (consol.), Order at 67-69 (Nov. 21, 2006); *Central Ill. Light Co.*, Docket No. 99-0119 and 99-0131 (consol.), Order, 1999 WL 1005210 at 34-36 (Aug. 25, 1999). Nicor Gas' ICU Plan does not and did not simply pay monetary compensation to certain employees for the Company's achievement of financial goals. Instead, the ICU Plan offered compensation in two steps. First, upon the achievement of certain Company related goals, an employee would qualify for compensation under the ICU Plan through share points. *See* Staff Cross Ex. 3, DLH-13.02, Ex. 1 at 5. Second, whenever the Company would pay stock dividends, holders of share points would receive monetary payment based on their number of share points. *Id*. Staff's claim that the payment of benefits is based entirely on company performance completely overlooks the fact that the event that qualifies an employee for the ICU Plan is not related to Company financial goals. In short, the share points are the means of reward under the ICU Plan. The value of the point shares fluctuates according to stock value and Company performance. For all of these reasons, the Company's costs for its ICU Plan should be allowed.

2. Uncollectible Accounts Expense

(a) Nicor Gas' Proposed 2.25% Uncollectible Expense Rate is the Most Accurate Predictor of Uncollectible Expense for the 2009 Future Test Year

Nicor Gas' proposed Uncollectible Expense rate of 2.25% results in the most reasonable estimate of Uncollectible Accounts Expense. Nicor Gas has shown its uncollectibles rate is reasonable in light of the trend in rising charge-off, with the resultant increase in uncollectible expense. *See*, *e.g.*, Gorenz Dir., Nicor Gas Ex. 11.0; Kirby Dir. Corr., Nicor Gas Ex. 6.0; O'Connor Dir., Nicor Gas Ex. 12.0; Gorenz Reb. Corr., Nicor Gas Ex. 26.0; Kirby Reb., Nicor Gas Ex. 21.0; O'Connor Reb. Corr., Nicor Gas Ex. 27.0; Kirby Sur., Nicor Gas Ex. 40.0. The Company also has demonstrated that, historically, the Company's forecast of Uncollectible Expense has been conservative, as actual Uncollectible Expense has exceeded the budgeted amount. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 12:243-13:251. No party disputed this point. Indeed, the Company's Uncollectible Expense rate of 2.25%, proposed at the outset of this proceeding on April 29, 2008, likely may be too low given the undisputed worsening economic conditions that have occurred during the pendency of this proceeding.

Ignoring deteriorating economic conditions, AG/CUB argue that the Company's Uncollectible Expense rate should be reduced to a rate below that being experienced in 2008. AG Init. Br. at 15-6; CUB Init. Br. at 9-11. The AG claims that the data provided by Nicor Gas in support of the upward trend in Uncollectibles Expense are insufficient to establish a trend that "the actual charge-off rate has varied over the past several years." AG Init. Br. at 15. AG/CUB's proposed Uncollectible Expense adjustments fails to account for this upward trend. In fact, AG/CUB's recommendation takes an unwarranted and unreasonable step backward, applying only 2006 and 2007 data for a recommended 2009 Uncollectible Expense rate of 1.8%. This recommendation, if adopted by the Commission, would penalize Nicor Gas for economic conditions outside of its control and, given the enormity of the problem, largely would negate any relief afforded to Nicor Gas in addressing its current revenue deficiency. Meanwhile, Staff recognizes the evidence demonstrating the obvious upward trend in the Uncollectible Expense rate, but fails to consider the continuation of that trend in 2009, proposing to reduce the rate to 2.02%. Each of these proposals should be rejected, and are addressed in turn below.

The AG claims that the Company's actual charge-off data for 2007, at 2.18% of 12 month lagged revenues, somehow represents an "outlier" year which should be disregarded. The AG argues that though the 2007 data shows a marked increase in charge-off, "this one year experience does not establish a trend." *Id*. Conversely, and self-servingly, the AG claims that the charge-off data for 2006, at 1.23% of 12 month lagged revenues, is definitive evidence that a trend does not exist. *Id*. The AG's tortured logic disregards the reality of the Company's current uncollectibles environment. The Company has presented uncontroverted evidence regarding its most recent charge-off data. Nicor Gas Init. Br. at 31-35. The data presented included the most current actual charge-off levels from 2007 and from 2008, which AG/CUB witness Effron disregards. Instead, he creates an average charge-off rate, gleaned from the "outlier" 2007 year and from 2006, resulting in a 1.8% percentage rate and corresponding $13,235,000 operating expense adjustment. Effron Dir., AG/CUB Ex. 1.0, 2:18-3:3; Effron Reb., AG/CUB Ex. 4.0, 11:4-17; AG/CUB Ex. 4.1C, Sch. C-2.2.

The AG also appears to suggest that Mr. Effron's analysis favors Nicor Gas, since he could have looked even further back in time to include 2005 charge-off data in computing his average uncollectible rate. AG Init. Br. at 15. In this regard, Mr. Effron suggests that the Commission has expressed approval of a three-year average to calculate uncollectible expense. Effron Reb., AG/CUB Ex. 4.0, 11:4-17. As Staff recognized in its Initial Brief, Mr. Effron's citation to the 2007 Ameren Rate Case is of little relevance given that Ameren employed a historical test year, not a future test year. Staff Init. Br. at 28. Mr. Effron's insistence on selective historical data is misplaced; the use of estimates is both necessary and expected when employing a future test year. 83 Ill. Adm. Code 287.20; 83 Ill. Adm. Code 285, Subpart J (Future Test Year Requirements).

The AG also claims that its witness did consider 2008 data in his calculations. AG Init. Br. at 15. However, the AG does not provide any citation to these "several calculations" involving 2008 data. *Id*. Further, in referring to the calculations purportedly performed using 2008 data, the AG misrepresents evidence in the record. The AG states: "Based upon the Company's actual charge-offs in 2008 as compared to actual lagged revenues in 2008, the result would be a rate of .89%." *Id*. Again, the AG did not, and cannot, show where Mr. Effron presented this erroneous calculation in evidence, because he did not. In addition, it is unclear where the AG is looking to determine "actual lagged revenues in 2008." *Id*. The AG's representation of actual 2008 charge-off experience is erroneous. Actual 2008 charge-offs as a percentage of lagged revenues exceed any numbers presented by the AG or even Staff.

While CUB and the AG presented Mr. Effron as a shared AG/CUB witness, it does not appear that CUB and the AG share an understanding of the bases of Mr. Effron's opinion. In its Initial Brief, CUB takes issue with the Company's proposed Uncollectible Expense by stating: "[g]iven the nature of inherent stableness or minor fluctuations in this expense in recent years, Mr. Effron testified that it would be inappropriate to base uncollectibles expenses solely on the actual uncollectible accounts expense in 2007, as Nicor has done." CUB Init. Br. at 10. This is a misstatement of both Nicor Gas' and Mr. Effron's position. Mr. Effron acknowledges that the lagged charge-off rate was 2.18% for 2007, but does not suggest that Nicor Gas seeks to use the actual lagged 2007 charge-off rate for its current uncollectible expense calculation. To the contrary, while Mr. Effron argues that historical charge-off rates should be used to determine the appropriate uncollectible expense rate to be applied for the 2009 test year, he does not wish to use the 2.18% actual historical rate because he considers 2007 an "outlier." Meanwhile, Nicor Gas demonstrates an upward trend in charge-off, and that the upward trend will result in an uncollectible expense rate that is higher for 2009 than the 2007 percentage; the Company has presented evidence that 2.25% is the estimated rate for 2009.[4]

Finally, Staff's proposed Uncollectible Rate of 2.02% also is flawed. Staff Init. Br. at 27-28. While Staff's analysis properly recognizes the historical upward trend in charge-off, Staff's position fails to consider the economic realities facing the Company in 2009. Staff's proposed adjustment looks only to 2007 and 2008 actual data, and assumes no changes in the Uncollectible

[4] CUB also claims that "there is no evidence of how the Company arrived at the 2.25% rate." CUB Init. Br. at 9. CUB's assertion is wrong. Nicor Gas explained fully the manner in which it derived the 2.25% rate. *See* Nicor Gas Init. Br. at 32-34.

Expense rate for 2009. *Id*. There can be no doubt given the current economic climate that the Uncollectible Expense rate will exceed actual past experience, consistent with the Company's 2009 forecast. For these reasons, the Commission should not accept Staff's adjustment. If, however, the Commission should determine that an adjustment is warranted, it should go no lower than Staff's proposal, which at least more closely reflects the most recent actual experience of the Company.

For the reasons set forth in testimony and in the Company's Initial Brief, Nicor Gas' Uncollectible Expense rate of 2.25% should be approved.

3. Rate Case Expense

Staff continues to assert that the Commission should amortize rate case expense over a four-year period rather the Company's proposed three-year period. Staff Init. Br. at 28-30. Staff argues that its witness has presented a "reasonable basis" for its proposal to amortize rate case expense over four years. *Id*. However, the question presented is not whether Staff has presented a reasonable proposal. Rather, the question is whether Nicor Gas has presented a reasonable amortization period for rate case expense. Staff does not claim that Nicor Gas' proposal is unreasonable, even though it is clear that the Commission must be presented with a challenge to the proposal's reasonableness in order to supplant the Company's proposal with Staff's alternative. *See, e.g., BPI v. Ill. Commerce Comm'n*, 279 Ill. App. 3d 824, 829-30, 665 N.E.2d 553, 556 (1st Dist. 1996). Instead, Staff questions whether the Company logically would present a rate case in three years if its Rider VBA and Rider EEP proposals are accepted. Staff Init. Br. at 28-30. Staff's appeal to logic is legally insufficient to show that the Company's three-year amortization period is unreasonable. Moreover, Staff's claim is directly at odds with the fact that Staff does not support either Riders VBA or Rider EEP. *See* Staff Init. Br. at 152-57. As demonstrated in evidence and in its Initial Brief, Nicor Gas' proposed three-year amortization period, which is based upon the three-year period between its last and current rate case proceedings, is reasonable and should be adopted. Nicor Gas Init. Br. at 35-36.

4. Payroll / Headcount

The AG/CUB's proposed adjustment to Payroll Expense is unreasonable, as it would establish an employee headcount for 2009 that is *below* the Company's actual headcount at the end of October 2008. D'Alessandro Sur., Nicor Gas Ex. 37.0, 14:322-15:335 *citing* Effron Reb., AG/CUB Ex. 4.0, 9:8-12. As explained in detail in the Company's testimony and Initial Brief, Nicor Gas' proposed 2009 headcount and related Payroll Expense is reasonable. Nicor Gas does not seek to reduce headcount for 2009 but must increase headcount beyond current levels to meet its work requirements. *See* Nicor Gas Init. Br. at 36-38. Staff supports the Company's proposed test year headcount and rejects AG/CUB's proposed adjustment. Staff Init. Br. at 30. Accordingly, AG/CUB's proposed adjustment should be rejected.

AG/CUB propose an adjustment to Payroll Expense based upon AG/CUB witness Effron's flawed analysis.[5] AG Init. Br. at 16-17; CUB Init. Br. at 11-12. Both the AG and CUB argue that the Company's proposed payroll expense should be adjusted based upon a difference between the number of actual and budgeted/authorized employees.[6] *Id*. In testimony, Nicor Gas witness D'Alessandro explained that the AG/CUB analysis fails to address that the impact of Mr. Effron's proposal is to *reduce* the average headcount for 2009 to 2,224. D'Alessandro Sur., Nicor Gas Ex. 37.0, 14:322-15:335 *citing* Effron Reb., AG/CUB Ex. 4.0, 9:8-12. The

[5] CUB requests that the Commission reduce the Company's Payroll Expense by $1,636,000, which actually is the amount of the reduction that Mr. Effron made to his initial proposed Payroll Expense adjustment, in an effort to correct double-counting issues associated with his original proposal. *See* Effron Reb., AG/CUB Ex. 4.0, 10:8-19. In rebuttal testimony, Mr. Effron's proposed Payroll Expense adjustment was reduced to $2,602,000 from the $4,460,000 proposed in his direct testimony. Effron Dir., AG/CUB Ex. 1.1; Effron Reb., AG/CUB Ex. 4.1C, Sch. C-2.1.

[6] The AG misstates Mr. Effron's proposed adjustment. In rebuttal testimony, AG/CUB witness Effron reduced the proposed adjustment to the equivalent of 101 headcount—not 106 headcount as stated in the AG's Initial Brief. Effron Reb., AG/CUB Ex. 4.0, 10:8-19; AG/CUB Ex. 4.1C, Sch. C-2.1.

Company's actual employee level at the end of October 2008 was 2,230. *Id*. Mr. Effron's proposal therefore seeks to impose a headcount reduction for 2009 that is below actual 2008 levels. *Id*. Both the AG's and CUB's Initial Briefs fail to address the impact of Mr. Effron's proposal.

Additionally, the AG also fails to address that the vast majority of the 2008 "variance" in actual versus budgeted/authorized headcount results from work currently being performed by contractors and employee overtime efforts. Nicor Gas witness D'Alessandro explains that the Company currently is incurring unbudgeted overtime and contractor expenses to meet the workload stemming from present employee vacancies. As a result of the headcount vacancies, the Company is incurring unbudgeted overtime and contractor expenses equivalent to 78 employees. D'Alessandro Reb., Nicor Gas Ex. 18.0, 12:261-14:327; D'Alessandro Sur., Nicor Gas Ex. 37.0, 14:313-16:353. AG/CUB's failure to consider these points further demonstrates the unreasonable nature of their proposed adjustment.

AG/CUB's proposed headcount adjustment should be rejected. Their proposal would reduce 2009 headcount below Nicor Gas' actual headcount as of October 2008. Moreover, AG/CUB fail to identify any work or activities that should be eliminated or reduced in order to meet their headcount proposal. Instead, they assume that the work will be performed with fewer employees, with no additional overtime and/or contractor expense. The evidence fails to support AG/CUB's unreasonable position.

5. Mains and Services Expenses

AG/CUB's arguments regarding Mains and Services Expenses, Account 874, disregards the evidence presented in this proceeding. The AG argues that "the sole explanation" offered by the Company for its increase in Account 874 Mains and Services expenses is a reclassification of accounts. AG Init. Br. at 17-18. Meanwhile, CUB asserts that the Company has not identified any factors that would cause Account 874 expenses to increase to Nicor Gas' test year level. CUB Init. Br. at 13. The Company provided a thorough explanation for each area of increase. *See* McCain Reb. Corr., Nicor Gas Ex. 20.0, 10:209-11:243; McCain Sur., Nicor Gas Ex. 39.0, 7:155-8:175. The AG and CUB fail to address Company witness McCain's detailed explanation supporting the cost increases. In contrast to AG/CUB, Staff has reviewed the Company's information supporting the forecasted increase in Mains and Services expense, and proposes no adjustment. Staff Init. Br. at 30-31. Absent any attempt at showing why the Company's Account 874 expenses are unreasonable, the Commission should reject the AG/CUB's proposal.

6. Customer Records and Collection Expenses

The AG chooses to address Nicor Gas' validation of its Account 903 expenses by summarily concluding that the Company's explanation is insufficient to explain "such a dramatic overall increase." AG Init. Br. at 18-19. CUB also relies on a similar claim. CUB Init. Br. at 13-14. The AG concedes that the Company's expected increase in postage related to the Bill Every Customer Every Month program will cause a large increase in expenses, and acknowledges that Nicor Gas witness Kirby has shown how each expense within the Company's forecast was calculated. AG Init. Br. at 18-19. Yet despite this acknowledgment, the AG falls back on its initial, arbitrary basis for its proposed adjustment: that "expected normal inflation and system growth" should not amount to more than a 5% increase per year. *Id*. Neither the AG nor CUB attempt to explain the basis for the 5% figure, nor do they contest the Company's support for these expenses.

Meanwhile, Staff proposes no adjustment to the Company's Customer Records and Collections Expenses. Staff Init. Br. at 31. Staff actually examined the Company's support for its Account 903 expenses. Therefore, Staff's analysis further supports the reasonableness of these expenses.

The Company presents persuasive, detailed evidence demonstrating that its Account 903 expenses are reasonable. Kirby Reb., Nicor Gas Ex. 21.0, 7:157-12:261. Neither the AG nor CUB responded in any fashion to this testimony. For these reasons, and those set forth in the Company's Initial Brief, Nicor Gas' proposed 2009 test year Customer Records and Collections Expenses should be allowed. Nicor Gas Init. Br. at 39-41.

7. Charitable Contributions

(a) Aurora Foundation

Staff objects to the recovery of costs for donations to the Aurora Foundation for merit scholarships. Staff claims that the donations are not charitable in purpose only because children of Nicor Gas employees are eligible for the merit scholarships funds. Staff Init. Br. at 31-32. Staff's position overlooks the language of Section 9-227 of the Act, which provides:

> It shall be proper for the Commission to consider as an operating expense, for the purpose of determining whether a rate or other charge or classification is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious or educational purposes, provided that such donations are reasonable in amount. … The Commission shall be prohibited from disallowing by rule, as an operating expense, any portion of a reasonable donation for public welfare or charitable purposes.

220 ILCS 5/9-227.

Staff offers no legal support for its claim regarding the nature of the Company's donation. Although "charitable purpose" is not defined in the Act, other Illinois statutes provide definitions. The Illinois Solicitation for Charity Act defines a charitable purpose broadly, as "any charitable, benevolent, philanthropic, patriotic, or eleemosynary purpose" 225 ILCS 460/1(f). Illinois courts have construed Section 460/1(f) as to include "almost anything that promotes the improvement or well-being of man." *See Estate of Stern*, 240 Ill. App. 3d at 837; *People ex rel. Scotty. George F. Harding Museum*, 58 Ill. App. 3d 408, 415, 374 N.E.2d 756 (1st

Dist. 1978). Under this broad definition, the scholarship fund administered by the Aurora Foundation undoubtedly is a charitable purpose. Accordingly, Staff's objection should be rejected.

Staff also objects to the donations on the ground that they do not serve the public welfare. Staff Init. Br. at 32. As set forth above, Section 9-227 requires that donations be either for the public welfare or a charitable purpose. The fact that the scholarships are not available to the general public does not place them outside the scope of Section 9-227. Moreover, the fact that only children of Nicor Gas employees are eligible for the scholarships has no bearing on whether the donation is charitable. Staff claims, without citing any legal authority, that because only children of Nicor Gas employees are eligible for the scholarships, they are potential employment benefits, and not charitable donations. Staff's claim is unavailing. Nicor Gas Init. Br. at 41-42.

Staff also cites Nicor Gas' policy against making charitable donations to foundations. Staff Init. Br. at 32. Staff's citation to this policy is of no help. The Company's donations to the Aurora Foundation are consistent with Company policy because, as Staff acknowledges, the Aurora Foundation serves only to administer the funds for scholarship awards. *Id.* at 31. For these reasons, Staff's proposed adjustment related to donations to the Aurora Foundation should be disregarded.

(b) Salvation Army – Chicago

Staff has provided no reason why it chooses, in its Initial Brief, to disregard sworn testimony regarding Nicor Gas' commitment to the Sharing Program. Staff Init. Br. at 32-33. Instead, Staff continues to argue that the Company's testimony is contradicted by the Sharing Program Agreement with the Salvation Army, which provides that Nicor Gas may request a refund if its matching contributions exceed customer contributions. *Id*. If Staff's concern is that Nicor Gas will seek a refund of a substantial portion of the $220,000 allowed as an operating expense, the concern is an understandable one: the Company's contract allows it to seek a refund of contributions that the Commission has allowed as an operating expense affecting base rates. In recognition of that concern, Nicor Gas Vice President Kevin Kirby provided sworn testimony that the Company is committed to fully support the Sharing Program regardless of the level of customer donations. Kirby Sur., Nicor Gas Ex. 40.0, 5:113-6:122; Nicor Gas Ex. 40.1. Thus, it is clear that the Company will not seek a refund of these donated funds, as Staff apparently fears.

Staff also suggests that the Commission should look to decisions in rate cases from 1993 and 1995 for guidance on excluding matching contributions from operating expenses. Staff Init. Br. at 33. Yet Staff fails to address recent Commission Orders approving similar "add-a-dollar"-matching programs. *See,* 2007 Peoples Rate Case Order; 2007 ComEd Rate Case Order; 2007 Ameren Rate Case Order. As described fully in its Initial Brief, Nicor Gas is not alone in offering of matching contribution programs. Staff does not claim that the purpose of the Sharing Program is unreasonable. Nicor Gas Init. Br. at 42-43. Given today's economic climate, it would be poor public policy to disincent a utility from contributing to a sharing program that assists customers in paying their bills by disallowing recovery of this clearly charitable expense. For all of these reasons, the Commission should allow Nicor Gas to recover contributions to the Sharing Program.

8. Depreciation and Amortization Expenses

Staff and the Company agree upon the calculation methodology to be used to adjust depreciation expense should the Commission Order adjustments to utility plant. *See* Staff Init. Br. at 33.

9. Income Taxes

Nicor Gas incorporates herein the discussion of Income Taxes from Subsection V.C.9 of its Initial Brief.

10. Interest Synchronization

Nicor Gas incorporates herein the discussion of Interest Synchronization from Subsection V.C.10 of its Initial Brief.

VI. RATE OF RETURN

A. Uncontested Issues

Nicor Gas incorporates herein the discussion of Uncontested Issues from Subsections V.C.9.1-2 of its Initial Brief.

B. Contested Issues

1. Capital Structure (Inclusion of Short-Term Debt)

(a) Inclusion of Short-Term Debt

The Commission has spoken unambiguously about short-term debt. In a rate proceeding, "[t]he key determination on whether short-term debt is included or excluded from the capital structure is the *purpose* of the short-term debt." 2004 Rate Case, Order at 71 (original emphasis). In its Initial Brief, Staff offers no argument or evidence to support a finding that Nicor Gas' use of short-term debt has changed in any way over the past three decades. There is none. The record shows that Nicor Gas uses short-term debt today in the same manner as it has historically—"to finance the temporary, seasonal cash requirements of the Company and *not* to finance its rate base assets." Ruschau Reb., Nicor Gas Ex. 24.0, 8:181-82 (emphasis provided). Staff's Initial Brief omits any reference to this unambiguous standard or to the Commission's determination to exclude short-term debt from Nicor Gas' capital structure in each of the Company's last three rate cases. 2004 Rate Case, Order at 69-72; 1995 Rate Case, Order at 37;

1987 Rate Case, Order at 20-27. The Commission's analysis of the short-term debt issue in this proceeding reasonably could stop here.

The Commission should adopt the Company's proposed capital structure of 56.77% common equity, 0.12% preferred stock, and 43.11% long-term debt. Nicor Gas Init. Br. at 45-48; Ruschau Reb., Nicor Gas Ex. 24.0, 4:98-99; Nicor Gas Ex. 24.1. The Company's capital structure proposal reflects its forecasted actual average capitalization in the 2009 test year, prior to the effect of the proposed rate increase. Ruschau Reb., Nicor Gas Ex. 24.0, 5:123-24. The proposed capital structure does *not* include short-term debt, because Nicor Gas does *not* use short-term debt to finance rate base assets or to make long-term investments in rate base. *Id.*, 8:178-9:189. The proposed capital structure mirrors the capital structures approved by the Commission in the 1987, 1995 and 2004 Rate Cases. *Id.*, 7:157-64 (*see* Figure 1 below). Staff does not dispute that Nicor Gas' historically prudent and stable capital structure has helped insulate the Company from unfavorable market conditions and financial stress and reduced Nicor Gas' cost of debt and other costs of doing business. *Id.*, 6:128-32.

FIGURE 1

Prior Nicor Gas Rate Cases	% Equity	% Pref.	% Debt
Docket No. 04-0779	56.4%	0.1%	43.5%
Docket No. 95-0219	58.1%	0.9%	41.0%
Docket No. 87-0032	59.2%	1.6%	39.2%
Average	**57.9%**	**0.9%**	**41.2%**
Company Proposal in this Case	56.8%	0.1%	43.1%

Ruschau Reb., Nicor Gas Ex. 24.0, 7:164.

Nonetheless, Staff asks the Commission to reject three decades of consistent fact-based ratemaking and adopt a hypothetical capital structure for Nicor Gas consisting of 46.36%

common equity, 0.10% preferred stock, 35.22% long-term debt, and 18.32% short-term debt.[7] Staff Init. Br. at 35-42; Freetly Reb., Staff Sch. 18.1C. In support of this jarring adjustment, Staff argues incorrectly that Nicor Gas "has not demonstrated that short-term debt does not support rate base." Staff Init. Br. at 37. Staff also pursues the same fully rebutted theories it pursued in the testimonial phase of this proceeding. Staff asserts that since certain of Nicor Gas' proposed rate base assets have seasonal characteristics, then short-term debt somehow must be financing rate base. *Id*. at 37-38. And Staff erroneously argues that the difference between Nicor Gas' proposed regulatory rate base and its book value capitalization indicates that "the Company is incorporating a 'cushion' into its requested rate of return." *Id*. at 40-42.

Nicor Gas addresses each of these positions below. First, however, Nicor Gas corrects a misstatement contained in Staff's Initial Brief, which asserts that "the Company's proposed capital structure mistakenly used December 31, 2009 balances for long-term debt and preferred stock in its 'average 2009' capital structure proposal. Staff Init. Br. at 35. As clearly indicated on Nicor Gas Ex 24.1, and illustrated in the workpapers to that exhibit (also filed with the Commission), the amounts reflected in each component of Nicor Gas' proposed test year capital structure represent 13-month averages. Ruschau Reb. Corr., Nicor Gas. Ex. 24.1 at n. 1.

(i) Nicor Gas' Actual Capital Structure

Staff's first argument, that Nicor Gas "has not demonstrated that short-term debt does not support rate base," has a fundamental problem: It disregards the evidence which shows that Nicor Gas uses short-term debt to meet the seasonal needs of running its gas distribution operations—and *not* to finance long-term rate base assets. *Compare* Staff Init. Br. at 37-39 and

[7] CUB adopted Staff's short-term debt adjustment in its witness Thomas' rebuttal testimony (without explanation or analysis) but did not address the issue in its Initial Brief. *See* Thomas Reb., CUB Ex. 2.0, 13:255-67.

Ruschau Reb., Nicor Gas Ex. 24.0, 8:177-13:280; Ruschau Sur., Nicor Gas Ex. 43.0, 5:105-7:153.

As Nicor Gas' Vice President and Treasurer Douglas M. Ruschau testified, various factors drive seasonality in cash flow at Nicor Gas, including customer consumption patterns (mostly due to weather), revenue billing and collection patterns, natural gas storage injection/withdrawal cycles, the level of gas prices, and the timing of a variety of receipts and expenditures. Ruschau Reb., Nicor Gas Ex. 24.0, 9:191-95. Nicor Gas uses short-term debt to help manage this variability in cash flow and to avoid the need to maintain excess amounts of permanent, more expensive long-term capital on a year-round basis. *Id.*, 9:196-99. This approach makes good business sense. Good business sense and logic also dictate that:

> [L]ong-term assets should be financed in the long run by long-term sources of funding. This matching principle is a basic tenet of sound financial management. To put the issue in perspective, one would not likely purchase a home that he or she intended to live in for the next 30 years and finance that purchase indefinitely on a Visa card.

Id., 19:429-20:433.

The uncontradicted evidence shows that Nicor Gas consistently has no short-term debt outstanding for several months every year. Nicor Gas has had no short-term debt outstanding for an average of five consecutive months in each year since its 2004 Rate Case. Ruschau Sur., Nicor Gas Ex. 43.0, 6:120-22. Since 1987, the period spanning Nicor Gas' last three rate proceedings, the Company has had no short-term debt outstanding for an average of four consecutive months each year. *Id.*, 7:149-51. Despite its incompatible position in this proceeding, Staff has agreed with the Company in the past that the absence of short-term borrowing for several months of the year definitively shows that short-term debt cannot be the source of rate base financing. 1987 Rate Case, Staff Init. Br. at 62 (Oct. 1987).

Similarly, there is no dispute that Nicor Gas faces the same need today to respond to daily and seasonal cash flow requirements, including gas costs, as it has in the past. Ruschau Sur., Nicor Gas Ex. 43.0, 6:144-47. This finding was essential to the Commission's determination to exclude short-term debt from Nicor Gas' capital structure in the 2004 Rate Case. 2004 Rate Case, Order at 72. Staff offers no contrary argument or evidence in its Initial Brief, and there is none.

Nicor Gas also demonstrated the highly negative practical effect of Staff's proposal to impute $236 million of short-term debt into the Company's capital structure for ratemaking purposes which would degrade Nicor Gas' credit profile, weaken its financial condition, and increase its financial risk. Ruschau Reb., Nicor Gas Ex. 24.0, 20:441-51. Over time, degradation in the Company's financial condition and credit profile could result in higher long-term and short-term interest expense, higher financing costs, and higher costs to provide credit support in various forms to counterparties, including its natural gas suppliers. *Id*., 21:452-68.

In its Initial Brief, Staff argues that a dramatically more levered capital structure would not create risk, because "interest rates the Company pays on its short-term debt will vary regardless of whether or not the Commission includes short-term debt in the capital structure." Staff Init. Br. at 38-39. This argument misses the mark. As Mr. Ruschau showed, Staff takes the position that Nicor Gas is, or by implication, should be financing approximately 18% of its rate base with short-term debt. Ruschau Sur., Nicor Gas Ex. 43.0, 9:204-10:220. If Nicor Gas actually were to finance its fixed investments in such any such manner (and it does not today), the debt-heavy capital structure definitively would cause greater earnings instability due to the high degree of volatility in short-term interest rates and financial uncertainty regarding long-term availability of short-term funds to finance long-term assets in rate base. *Id*.

Additionally, Staff argues that its proposed debt-heavy capital structure "is commensurate with a strong degree of financial strength." Staff Init. Br. at 39. In particular, Staff asserts that it proposed common equity ratio of 46.42% "compares favorably with other companies in the gas distribution industry." *Id*. at 39. The evidence, however, shows that Staff performed no analysis to support the comparability to Nicor Gas of the companies included in the industry database Staff employed. Ruschau Sur., Nicor Gas Ex. 43.0, 10:239-11:244. Staff could not even identify the companies in the database. *Id*.

The evidence also shows that Staff's credit ratio analysis (which supposedly forecasts the effect of Staff's proposed revenue requirement on Moody's pro forma 2009 credit ratios for Nicor Gas) does not properly reflect the applicable credit rating methodology and sharply underestimates the negative impact of Staff's proposal on the Company's credit profile. Ruschau Reb., Nicor Gas Ex. 24.0, 21:469-23:501; Ruschau Sur., Nicor Gas Ex. 43.0, 11:249-12:277. Staff's credit analysis also fails to consider the many qualitative ratings factors considered by the rating agencies in their rating process. *Id*. .

The Commission should not credit Staff's speculation that its request to break with longstanding regulatory policy and impute a large short-term debt component into Nicor Gas' capital structure in this proceeding would have no real world consequences. Staff's gamble is a bad bet for Nicor Gas and its customers. As Mr. Ruschau concluded: "In the current difficult financial environment and credit market, it is more important than ever that Nicor Gas avoid … credit degradation and preserve its financial strength and flexibility." Ruschau Sur., Nicor Gas Ex. 43.0, 13:284-91.

(ii) Staff's "Correlation" Theory

Second, Staff argues that "since Nicor Gas includes assets with balances that exhibit a high degree of seasonal variation through the test year in its rate base," then Nicor Gas somehow "must" be funding rate base with short-term debt. Staff Init. Brief at 37-38. As support for this theory, Staff witness Freetly identifies a correlation between monthly changes in Nicor Gas' short-term debt and working capital account balances as shown on the Company's balance sheet. Staff Init. Br. at 37-38.

However, as shown in Mr. Ruschau's rebuttal testimony, this correlation is neither surprising nor is this statistic supportive of Staff's conclusion. *See* Ruschau Reb., Nicor Gas Ex. 24.0, 17:367-71. Mr. Ruschau testified that, "Nicor Gas uses short-term debt to help meet its seasonal cash needs, including those resulting from seasonal fluctuations in working capital requirements." *Id*. at 369-71. The CWC component of rate base is not derived from the balance sheet working capital accounts used in Ms. Freetly's analysis, nor is it a temporary, seasonal need. It is derived from a lead-lag study, which is the method endorsed and accepted by the Commission for determining the working capital component of a utility's rate base. *See* Adams Dir., Nicor Gas Ex. 8.0, 3:59-4:70. It represents the permanent funds necessary for the day-to-day running of the utility, in addition to other permanent rate base assets, due to the ongoing lag in time between when costs are incurred and payment is received.

Ms. Freetly also contends that Gas in Storage is being supported by short-term debt. But, again, Mr. Ruschau demonstrated on rebuttal that seasonal increases in storage are accounted for and financed mostly outside of rate base, and the Company earns no return on this temporary seasonal increase in storage inventory. In contrast, the Gas in Storage asset included in rate base is based on the Company's original cost of net injections (normalized through a 13-month average, similar to other rate base assets that fluctuate through the year) and is a permanent, long-term investment supported by long-term capital. Ruschau Reb., Nicor Gas Ex. 24.0, 17:379-18:407.

Staff attempts to introduce new information into the proceeding in its Initial Brief in the form of a chart that compares the balances of short-term debt to the sum of two other balance sheet accounts—customer accounts receivable and Gas in Storage. Staff Init. Br. at 38. Aside from the fact that the chart and underlying data used to construct it were not introduced as evidentiary support in this case, the chart is misleading and not relevant to the issue at hand. Customer accounts receivable amounts are not included in rate base, despite the implication from the chart that they are. As for Gas in Storage, as noted earlier, most of the seasonal increase in storage is accounted for and financed outside of rate base.

Staff's argument that "the monthly amounts of short-term debt outstanding closely track the sum of gas in storage and customer accounts receivable" is not new or persuasive. Staff Init. Br. at 37. Staff made the same argument without success in the Company's 2004 Rate Case. 2004 Rate Case, Order at 72. Staff's related conclusion that "short-term debt is a permanent source of seasonal funds for Nicor Gas" is nothing more than a contradictory turn of phrase. Staff Init. Br. at 38. Short-term debt is either permanent or seasonal—it cannot be both.

Finally, Staff's attempt to associate short-term debt with CWC and Gas in Storage constitutes tracing of funds from source to use, which Staff agrees cannot be done due to the fungible nature of cash. Freetly Reb., Staff Ex. 18.0C, 6:111-12. Staff's use of a proposed 13-month average of short-term debt in the Company's capital structure likewise has no logical support, as it cannot be reconciled with or linked to any rate base asset despite Staff's awkward efforts to do so.

(iii) Staff's "Reconciliation" Theory

Staff's third argument is that the difference between Nicor Gas' proposed rate base and its book value capitalization implies that the Company's requested rate of return includes a "cushion" against interest rate exposure. Staff Init. Br. at 40-42. Staff seeks to support this argument with an erroneous calculation of an "*implied return on total capital*" of 12.18%, as compared to the *actual* 9.27% overall rate of return sought by Nicor Gas. *Compare* Staff Init. Br. at 40-41 (emphasis provided) and Ruschau Sur., Nicor Gas Ex. 43.0, 15:327-36. To reach this result, Staff simply miscalculates Nicor Gas overall rate of return by basing Staff's "implied" figure on the Company's (smaller) balance sheet capitalization, rather than its (larger) rate base. *See* Ruschau Reb., Nicor Gas Ex. 24.0, 15:337-16:349; Ruschau Sur., Nicor Gas Ex. 43.0, 10:221-29.

This approach to the calculation has no foundation in Illinois utility regulatory policy and practice. *Id*. As Mr. Ruschau explained: "There is no 'cushion' in [the Company's] requested rate of return, since it requires a return on *rate base* that is commensurate with the cost of these long-term sources of capital." Ruschau Sur., Nicor Gas Ex. 43.0, 10:225-27 (emphasis provided). Put another way, Staff's erroneous calculation is just another way of saying that rate base must equal capitalization, which Ms. Freetly admits is not the case. Freetly Reb., Staff Ex. 18.0C, 13:264-65. At a practical level, there is no dispute that the Company has not earned its authorized net operating income for several years, which strongly contradicts Staff's insinuation that use of Nicor Gas' actual capital structure in this proceeding would produce a windfall for the Company. Ruschau Reb., Nicor Gas Ex. 24.0, 16:350-52.

It also is important to note that significant differences between rate base and capitalization are not a new phenomenon. As Mr. Ruschau stated in his rebuttal testimony, differences between rate base and capitalization of similar magnitude to this case have existed in Nicor Gas' last three rate cases. Ruschau Reb., Nicor Gas Ex. 24.0, 15:330-31. However, the Commission has not used such differences alone as a basis for imputing short-term debt in the capital structure. The Commission has stated that "differences between Respondent's capitalization and rate base is not a *prima facie* evidence that short-term debt is financing rate base." 1987 Rate Case, Order at 26; *see* Ruschau Reb., Nicor Gas Ex. 24.0, 14-15.

(b) Adjustments to Other Capital Components Based Upon the Calculation of AFUDC Balances

Staff argues for various reductions in Nicor Gas' rate base based upon Nicor Gas' other capital component balances. Staff Init. Br. at 42-44. As shown by Mr. Ruschau, these adjustments are unnecessary and result solely from Staff's proposal to impute short-term debt into the Company's capital structure. Ruschau Reb., Nicor Gas Ex. 24.0, 26:559-27:582; Ruschau Sur., Nicor Gas Ex. 43.0, 14:314-25.

2. Cost of Short-Term Debt

Staff argues for a test year cost of short-term debt of 2.50%. Staff Init. Br. at 46. In the event the Commission were to include short-term debt in its capital structure, and it should not, the evidence shows that a more appropriate test year cost of short-term debt would be 3.72%. Ruschau Reb., Nicor Gas Ex. 24.0, 24:513-25:558.

3. Cost of Common Equity

(a) ROE Calculation

In their Initial Briefs, Staff and CUB offer no rationale for departing from sound Commission policy and practice for determining Nicor Gas' fair ROE in this proceeding. Nicor Gas recommends an 11.15% fair ROE. Makholm Reb. Corr., Nicor Gas Ex. 25.1. As discussed in its Initial Brief, Nicor Gas developed and presented its ROE proposal using the same proven calculation methodology employed in the Company's 2004 Rate Case. Nicor Gas Init. Br. at 54-55; 2004 Nicor Gas Rate Case, Order at 86-88. The Commission should adopt Nicor Gas proposed fair 11.15% ROE for purposes of determining the Company's overall authorized rate of return.

Staff and CUB each ask the Commission to adopt unproven methodologies for determining Nicor Gas' ROE. These approaches result in inequitable ROE recommendations and inadequate overall rates of return that would prevent the Company from recovering its prudently incurred costs of service. Ruschau Sur., Nicor Gas Ex. 43.0, 3:49-52. These proposed ROEs, 9.68% and 9.455%, respectively, are far below the fair costs of equity determined by the Commission in other recent major rate proceedings. Nicor Gas Init. Br., Fig. 3 at 54.

The briefing reflects no disagreement on the standard for determining Nicor Gas' fair ROE. Nicor Gas and CUB agree that the U.S. Supreme Court has required that regulated utilities receive a competitive return. Nicor Gas Init. Br. at 54 citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281 (1944) and *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of the State of W. Vir.*, 262 U.S. 679, 43 S.Ct. 675 (1923); CUB Init. Br. at 15-16 (same). Staff acknowledges that Nicor Gas' fair ROE "must provide a rate of return on common equity sufficient to meet investor requirements." Kight Garlisch Dir., Staff Ex. 6.0C, 3:49-50. While Staff does not directly address the regulatory standard in its Initial Brief, its ROE witness Kight-Garlisch agreed at hearing that the Commission must consider Nicor Gas' ability to compete for capital in determining the Company's fair ROE. Tr. at 501:4-506:7.

Nicor Gas and Staff agree to the basic approach the Commission should take in determining the Company's fair ROE. The Commission should take a simple average of the results produced by the capital asset pricing model ("CAPM") and the discounted cash flow ("DCF") cost of equity methods. CUB argues that the CAPM method should not be used. The specific disagreements between Nicor Gas, Staff, and CUB focus on the actual CAPM and DCF calculations, as well as Staff's proposal for an additional downward "risk adjustment" in Nicor Gas' calculated ROE. Summarized here; Nicor Gas addresses each of these points below.

(i) *CAPM*. Nicor Gas objects to Staff's proposal to mix raw and adjusted published betas for purposes of its CAPM calculation. Ms. Kight-Garlisch was unable to identify a single prior decision in which the Commission employed such an approach. Tr. at 500:18-501:3. Nicor Gas also disagrees with CUB's proposal to dispense with a CAPM analysis entirely in this proceeding.

(ii) *DCF*. Nicor Gas disagrees with Staff's use of a three-stage, non-empirically justified growth rate for its DCF calculation which subjectively limits the long-term earnings growth of Staff's utility sample to the presumed future growth rate of the U.S. economy. While effectively immaterial for purposes of the DCF calculation, Nicor Gas also disputes Staff's and CUB's criticism of its sustainable "S*V" growth rate estimate.

(iii) *Risk Adjustment*. Nicor Gas objects to Staff's proposed additional 25 basis point reduction in its ROE based on the Company's alleged lower financial risk relative to Staff's utility sample.

(i) CAPM

Nicor Gas witness Makholm uses the same CAPM calculation in this proceeding as the Commission adopted in the 2004 Rate Case. Makholm Sur., Nicor Gas Ex. 44.0, 5:104-119; 2004 Rate Case, Order at 86-87. Dr. Makholm calculates the Company's CAPM cost of equity at 11.93% using published and adjusted Value Line betas. Makholm Reb. Corr., Nicor Gas Ex. 25.1. This updated CAPM calculation, presented on rebuttal, reduced Nicor Gas' original recommended CAPM cost of equity by 17 basis points. *Compare* Makholm Dir., Nicor Gas Ex. 10.2. The Commission should adopt Nicor Gas' consistent analysis and the resulting 11.93% CAPM return for purposes of its ROE determination.

FIGURE 2: CAPM Cost of Equity Proposals

	Nicor Gas	Staff	CUB
Direct	12.10%	11.56%	NA
Rebuttal	11.93%	11.39% –or– 10.60%	NA
Recommended	**11.93%**	**10.60%**	**NA**

Staff witness Kight-Garlisch's erratic approach to the CAPM analysis presents a sharp contrast. On rebuttal, Ms. Kight-Garlisch abandoned her original CAPM methodology and, breaking with Commission practice and policy, mixed an *ad hoc* collection of adjusted and unadjusted (or raw) betas to reach a new sharply lower CAPM result. Kight-Garlisch Reb. Staff Ex. 19.0C, 10:164-11:192. To put Ms. Kight-Garlisch's revised proposal in a broader context, from August 27, 2008 to October 23, 2008, when Staff filed its Direct and Rebuttal Testimony, the Dow Jones Industrial Average plummeted a sickening 25%.[8] Over the same period, Ms. Kight-Garlisch reinvented Staff's ROE recommendation with an unprecedented CAPM approach that reduced Staff's overall recommended ROE from 10.16% to 9.68%. (Staff's DCF estimate did not change.)

On surrebuttal, Dr. Makholm criticized Staff's radical new approach as internally inconsistent and incompatible with the Commission's approach to the CAPM calculation in past rate proceedings, including Nicor Gas' 2004 Rate Case. Makholm Sur., Nicor Gas Ex. 44.0, 3:69-5:119. At hearing, Ms. Kight-Garlisch acknowledged as much. Tr. at 500:18-501:3. Nicor Gas witness Fetter, an expert in utility credit ratings and a former state utility regulator, also cautioned the Commission against the destabilizing effect of Staff's sharply reduced ROE

[8] The Commission or Hearing Examiner may take administrative notice of generally recognized scientific or technical facts within the specialized knowledge of the Commission, and of all other matters of which the Circuit Courts of this State may take judicial notice. 83 Ill. Adm. Code 200.640 (2008).

proposal, if adopted, in a period of "extreme" market turmoil. Fetter Sur., Nicor Gas Ex. 36.0, 3:47-4:71.

In briefing, Staff now invites the Commission to choose between three possible CAPM analyses and results (from Ms. Kight-Garlisch's direct and rebuttal testimony), although it only "recommends" the lowest proposal. Staff Init. Br. at 58-60. The Commission should decline Staff's invitation to calculate a critical element of Nicor Gas' fair ROE by lottery. *First*, the Commission should discard Ms. Kight-Garlisch's unprecedented proposal to mix adjusted and unadjusted betas for purposes of the CAPM calculation, which forms the basis for Staff's "recommended" 10.60% CAPM cost of equity. *Id*; Kight-Garlisch Reb., Staff Ex. 19.0C, 10:164-11:192. Staff offers no regulatory, academic or other support for this approach. In its own Initial Brief, Staff even equivocates that Ms. Kight-Garlisch's "inclusion of published raw betas should not be construed as Staff's agreement that raw betas are appropriate for CAPM analysis." Staff Init. Br. at 50.

Second, the Commission should reject Staff's "alternative" updated CAPM calculation, which employs the adjusted Value Line betas used by Nicor Gas and a selection of published raw betas, which Staff obtained and adjusted by hand. This approach produces an 11.39% CAPM result. Staff Init. Br. at 58-60; Kight-Garlisch Reb., Staff Ex. 19.0C, 12:207-13:223. While less inconsistent than Staff's *ad hoc* use of raw and adjusted betas to reach its "recommended" CAPM, Staff's alternative CAPM approach is equally subjective and untested. *See* Makholm Sur., Nicor Gas Ex. 44.0, 5:113-14 ("The objectivity of changing methods for performing basis cost of capital analysis in the middle of a rate case is questionable.").

Third, the Commission should disregard Ms. Kight-Garlisch's original CAPM proposal, which Staff implies should be adopted in the event the Commission (correctly) rejects her other

CAPM proposals. On direct, Ms. Kight-Garlisch calculated Nicor Gas' CAPM cost of equity at 11.56% using an average of adjusted Value Line betas and her own "regression beta" estimates. Staff Init. Br. at 58-60; Kight-Garlisch Dir., Staff Ex. 6.0C, 16:320-19:321. Staff employed a similar approach in the 2004 Rate Case, but the Commission selected the Company's CAPM methodology. 2004 Rate Case, Order at 86-87.

Finally, the briefing reflects Nicor Gas' and Staff's agreement that the Commission should reject CUB witness Thomas' recommendation to calculate Nicor Gas' fair ROE using only the DCF method and excluding the CAPM approach. Nicor Gas Init. Br. at 58; Staff Init. Br. at 64. Nothing in Mr. Thomas' supposed "academic evidence" or empirical analysis presented here favors elimination of the CAPM method from the Commission's accepted ROE methodology.

(ii) DCF

Nicor Gas' witness Makholm calculates a DCF cost of equity of 10.37%. Makholm Reb. Corr., Nicor Gas Ex. 25.1. Dr. Makholm employed the same approach to the DCF calculation here as adopted in the Company's 2004 Rate Case, including the use of three different prospective measures to estimate dividend growth. Makholm Dir., Nicor Gas Ex. 10.0, 23:470-478. Staff agrees that Dr. Makholm's eight-company peer group accurately reflect Nicor Gas' operating risk, although Staff excluded one utility (MGE Energy Corp.) from its DCF calculations.[9] Kight-Garlisch Reb., Staff Ex. 19.0C, 5:73-86. CUB also used Nicor Gas' peer group for its DCF calculation. *See* Thomas Dir., CUB Ex. 1.0, 29:710. The Commission should adopt Nicor Gas' consistent analysis and the resulting 10.37% DCF cost of equity for its ROE determination.

[9] Staff does not object to inclusion of MGE Energy Group in the utility sample, if the Commission adopts Dr. Makholm's DCF methodology. *Id*.

FIGURE 3: DCF Cost of Equity Proposals

	Nicor Gas	**Staff**	**CUB**
Direct	10.01%	9.25%	9.455%
Rebuttal	10.37%*	9.25%	9.455%
Recommended	**10.37%**	**9.25%**	**9.455%**

*Updated by using Staff's July 22, 2008 stock price date and excluding Nicor Gas' selling and issuance costs. Makholm Reb., Nicor Gas Ex. 250.0 Corr., 4:72-85

Staff and CUB recommend sharply lower DCF returns—9.25% and 9.455%, respectively. As reflected in the briefing, the main difference between Nicor Gas' and Staff's DCF approaches is Staff's use of a three-stage growth rate for its DCF calculation, in contrast to Dr. Makholm's single-stage model. Nicor Gas Br. at 57; Staff Init. Br. at 61-63. A second difference is the "S*V" component of Dr. Makholm's sustainable growth rate, which accounts for future dividend growth from new issuances of stock at a premium over book value. Both Staff and CUB take issue with Dr. Makholm's "S*V" component, although the effect of this factor is minimal. Staff Init. Br. at 60-61; CUB Init. Br. at 25-26.

In addition, CUB argues against inclusion of selling and issuance expense in Nicor Gas' DCF cost of equity. CUB Init. Br. at 23-25. However, to limit the contested issues, Dr. Makholm calculated his updated 10.37% DCF cost of equity excluding the Company's selling and issuance expense, rendering this portion of CUB's Initial Brief moot. Makholm Reb. Corr., Nicor Gas Ex. 25.0, 4:77-78.

Staff's Initial Brief contains two misstatements regarding Dr. Makholm's criticism of Staff's proposed three-stage growth rate model. *See* Staff Init. Br. at 61-63. *First*, Staff asserts that Dr. Makholm "provided nothing to support his assertion" that overall rate of growth of the economy is not a good proxy for the utility sample's long-term growth. Staff Init. Br. at 61. This argument misrepresents the record (as well as the discovery provided to Staff in this case) which demonstrates that "the measured productivity of utilities of all sorts … is consistently and persistently greater than the economy as a whole." Makholm Reb., Corr., Nicor Gas Ex. 25.0, 8:176-78. As Dr. Makholm showed, the Commission has examined the question and found that utilities generally exhibit "greater productivity growth than the economy as a whole." *See* Makholm Corr. Reb., Nicor Gas Ex. 24.0, at 10:232, n.5; *Ill. Bell Telephone Co*., Docket Nos. 92-0448 and 93-0239 (consol.), 1994 Ill. PUC LEXIS 437, at *83 (Oct. 11, 1994). While gas utilities realistically are not likely to grow in sheer size or annual throughput relative to the economy as a whole, the growth that matters for purposes of the DCF calculation is "*growth in earnings*," and the utility industry is uniquely positioned to sustain productivity and, hence, earnings growth. Makholm Corr. Reb., Nicor Gas Ex. 24.0, 11:245-12:266.

In contrast to Dr. Makholm's well-supported position, Ms. Kight-Garlisch fundamental assumption, that "no company could sustain into infinity a growth rate any greater than that of the overall economy, or it would eventually grow to become the entire economy," conveniently sidesteps any empirical test and, in doing so, misapprehends the entire field of utility productivity analysis, in which Dr. Makholm is an expert.[10] Kight-Garlisch Dir., Staff Ex. 6.0C, 5:94-96. In short, Staff's basic premise amounts to "pure speculation … tantamount to picking a growth rate out of thin air." Makholm Corr. Reb., Nicor Gas Ex. 25.0, 12:267-72.

Second, Staff misquotes Dr. Makholm's testimony. Staff Init. Br. at 62. Dr. Makholm stated that Ms. Kight-Garlisch's three-stage growth methodology is "without precedent *for Nicor Gas*," which is true. Makholm Sur., Nicor Gas Ex. 44.0, 2:21 (emphasis provided). The Commission has not applied a multi-stage growth rate to the DCF calculation in any prior Nicor Gas rate proceeding. And Staff has offered no empirically supported argument for changing

[10] For a complete discussion of the errors in Staff's approach to the long-term growth component of the DCF analysis, *see* Makholm Reb. Corr., Nicor Gas Ex. 25.0, 6:137-15:324; Makholm Sur., Nicor Gas Ex. 44.0, 6:122-10:227.

course here. Accordingly, the Commission should adopt Dr. Makholm's consistent approach to the long-term growth rate and the resulting 10.37% DCF cost of equity. Alternatively, the Commission should reject Staff's unverifiable second- and third-stage growth rate assumptions. Makholm Corr. Reb., Nicor Gas Ex. 25.0, 13:295-300. By Ms. Kight-Garlisch's admission, employing Staff's objective first-stage growth rate to the DCF calculation would produce a DCF return of 10.51%. Tr. at 495:12-19.

Regarding Dr. Makholm's "S*V" sustainable growth rate (relating to new issuances of stock at a premium to book value), Staff similarly confuses the record. Staff asserts that "Dr. Makholm failed to investigate the effect of exercised stock options on the price of the stock issued by the sample utilities." Staff Init. Br. at 61. However, Dr. Makholm carefully investigated the largest equity issuances by the utility sample. Makholm Sur., Nicor Gas Ex. 44.0, 12:256-13:286; *see* Makholm Reb. Corr., Nicor Gas Ex. 25.15. Those issuances—all of which were through public offerings at prevailing market prices—represent almost the entirety of common stock issuances by the utility sample during the relevant period and account for 24 of the 32 basis points Dr. Makholm included in his DCF calculation. *Id*. Thus, Staff and CUB's theoretical arguments against the "S*V" term, at best, account for 8 basis points. *Id*.

Finally, CUB witness Thomas asserts that the "S*V" term should be excluded from Dr. Makholm's DCF calculation, because Nicor Gas does not have any "concrete plans" to issue new equity. CUB Init. Br. at 26. But, as Dr. Makholm showed, the DCF analysis comes from an entire comparable group of companies, not just Nicor Gas. Makholm Reb., Nicor Gas Ex. 25.0 Corr., 18:406-19:415. And "experience shows that as a group the issuance of sizable blocks of new common shares is regular phenomenon." *Id*. Thus, the "S*V" term is objective and useful. Both Nicor Gas and Staff refute CUB's criticism of analysts' growth rate forecasts. *Compare*

CUB Init. Br. at 25 and Staff Init. Br. at 63; *see* Makholm Reb. Corr., Nicor Gas Ex. 25.0, 19:421-20:450.

(iii) Risk Adjustment

Nicor Gas' proposed 11.15% fair ROE takes a simple average of Dr. Makholm's 11.93% CAPM and 10.37% DCF calculations, consistent with the approach the Commission followed in the Company's 2004 Rate Case. 2004 Rate Case, Order at 86-88. As discussed above, the Commission should accept Dr. Makholm's consistent, transparent and empirically supported CAPM and DCF calculations for purposes of its ROE determination. Staff offers an unreliable mixed bag of CAPM results which the Commission should not consider in its ROE analysis. Both Staff and CUB understate Nicor Gas' DCF cost of equity, in Staff's case mainly by incorporating an unverifiable, multi-stage long-term growth rate into its calculations. In addition, Staff also argues for an after-the-fact downward 25 basis point risk adjustment to Nicor Gas' calculated ROE. Staff Init. Br. at 51-53, 57-58.

In the 2004 Rate Case, the Commission adopted a similar albeit smaller (23 basis point) risk adjustment to Nicor Gas' fair ROE. 2004 Rate Case, Order at 87-88. Nicor Gas disagreed with the Commission's downward risk adjustment in the 2004 Rate Case, and disagrees with Staff's proposal in this proceeding. As Dr. Makholm testified, Ms. Kight-Garlisch has not produced, nor could she produce, any evidence "to demonstrate that the equity markets agree[] with her regarding the relative risk of Nicor Gas *vis-a-vis* the comparable group of companies." Makholm Reb. Corr., Nicor Gas Ex. 25.0, 23:520-24:522. Put another way, while Ms. Kight-Garlisch may believe her analysis of Nicor Gas' relative credit risk is rational, "[e]quity and debt are very different financial securities [and] the difference between the bond yield of AA and A rate bonds has not tie [to] the differences in equity risk of comparing a proxy group to a single firm." *Id.*, 24:527-29. Staff's proposed risk adjustment should be rejected.

(b) Effect of Proposed Riders

Staff and CUB each argue in favor of yet another after-the-fact reduction in Nicor Gas approved ROE, depending on whether the Commission approves the proposed cost-recovery Riders VBA, UEA, and/or CUA. Staff Init. Br., 67-70; CUB Init. Br. at 28-31. Staff supports a 13 basis point reduction in ROE for Riders VBA and UEA. Staff Init. Br., 67-70. CUB argues for a 58 basis point reduction in ROE for Rider VBA (25 basis points), Rider UEA (25 basis points) and Rider CUA (8 basis points). CUB Init. Br. at 28-31. As noted in the Company's Initial Brief, the record contains no empirical support for these purely speculative adjustments. Nicor Gas Init. Br. at 59, citing Tr. at 507:22-508:6. Staff concedes that it cannot quantify "the precise impact" that adopting any of the Riders might have on the Company's credit profile, if at all. Staff Init. Br. at 68. The result is a wide discrepancy between Staff's and CUB's recommendations (13 v. 58 basis points), which supports the conclusion that these adjustment lack foundation. The sheer size of CUB's proposed downward adjustment—nearly six times the adjustment adopted in the 2007 Peoples Rate Case—does the same. As shown by Nicor Gas witness Dr. Makholm, the billing mechanisms contained in Nicor Gas' proposed riders have no effect on ROE. Makholm Reb., Nicor Gas. Ex. 25.0, 25:556-36:797; Makholm Sur., Nicor Gas Ex. 44.0, 13:288-16:355. Accordingly, the Commission should reject Staff's and CUB's proposals.

4. Overall Cost of Capital (Derivative)

The Initial Briefs, and the record of evidence, support Nicor Gas' proposed 9.27% overall rate of return. Nicor Gas Init. Br., at 59. This proposal, which incorporates Nicor Gas' proposed capital structure, its 11.15% fair ROE, its 6.80% embedded cost of long-term debt (uncontested), and its 4.77% embedded cost of preferred stock (uncontested), fairly reflects the costs to provide safe, reliability utility service. Ruschau Sur., Nicor Gas Ex. 43.0, 15:327-336. The Commission should reject Staff's and the AG/CUB's unreasonable proposed overall rates of return of 7.35% and 7.25%, respectively. Staff Init. Br. at 34; CUB Init. Br. at 27.[11]

VII. COST OF SERVICE AND ALLOCATION ISSUES

A. Overview

Nicor Gas' proposed cost revenue allocation is appropriate, equitable, and just and reasonable. Its Embedded Cost of Service Study ("ECOSS") is consistent with the ECOSS approved by the Commission in the 2004 Rate Case and the 1995 Rate Case it allocates costs on an equitable basis. No party opposes the Company's ECOSS or revenue allocation other than Illinois Industrial Energy Consumers ("IIEC"). IIEC's modifications to the ECOSS and its opposition to the Company's proposed revenue allocation should be rejected because they are inconsistent with prior Commission Orders, inaccurate, and unduly favor IIEC's particular economic interests. No other party supports IIEC's proposals.

1. ECOSS

In an effort to limit issues in this proceeding, Nicor Gas proposed the use of the Average & Peak ("A&P") method within the ECOSS, together with its Modified Distribution Main ("MDM") study. The Commission previously approved Nicor Gas' ECOSS using the A&P method, together with its MDM study. 2004 Rate Case, Order at 102; 1995 Rate Case, Order at 50.

Nicor Gas has responded to the concerns of Staff and the IIEC and those uncontested issues are discussed within Subsection V.B.1-2 of Nicor Gas' Initial Brief. IIEC proposes to modify the ECOSS in two ways, first by departing from the Commission's previously approved A&P volume allocation methodology for Transmission and Distribution ("T&D") mains and

[11] While CUB's Initial Brief states that Nicor Gas' overall rate of return "should be no more than 7.24% (sic)," its witness Thomas actually sponsored the 7.25% figure. Thomas Reb., CUB Ex. 2.0, 14:279-80.

second by departing from the previously approved storage cost allocation methodology. IIEC has failed to provide any compelling evidence or argument to justify rejecting the Company's accurate ECOSS or for the Commission to depart from its approved methodology.

2. Revenue Allocation

As set forth in its Initial Brief, Nicor Gas has demonstrated that its allocation of revenues is reasonable. Nicor Gas Init. Br. at 60-66. Staff agrees that the Company's revenue allocation proposal is reasonable. Staff Init. Br. at 75.

IIEC objects to the Company's revenue allocation proposal. It sets forth numerous revenue allocation proposals, some of which are now offered for the first time in its Initial Brief. IIEC Init. Br. at 11-14. No other party to this proceeding supports IIEC's revenue allocation proposals. IIEC's alternatives unduly favor IIEC's particular economic interest and neglects the Commission's Orders in prior natural gas rate cases. For the reasons set forth below, IIEC's proposals should be rejected.

B. Uncontested Issues

1. Allocation Factor Based Upon Services Investment by Customer Class

Nicor Gas incorporates herein the discussion of the uncontested issue, Allocation Factor Based Upon Services Investment by Customer Class from Subsection XII.B.1 of its Initial Brief.

2. Allocation of Storage Losses

Nicor Gas incorporates herein the discussion of the uncontested issue, Allocation of Storage Losses from Section XII.B.2 of its Initial Brief.

C. Contested Issues

1. Main Size Allocation

IIEC's proposal to extend the use of the MDM study to the reallocation of volume related allocators is inappropriate at this time. Nicor Gas cannot accept, and neither should the

Commission, an unintended and untested application of the Company's MDM study. Moreover, an extension of the MDM study to the reallocation of volume-related costs is inconsistent with prior Commission Orders and shifts millions of dollars of revenue recovery to the residential customer class.

Nicor Gas' ECOSS reproduces, without substantive change, the Commission-authorized cost classification and allocation methodology used in the 2004 Rate Case. Heintz Dir., Nicor Gas Ex. 15.0, 6:113-17. Moreover, the Company employed the same MDM methodology in its 1995 Rate Case. 1995 Rate Case, Order at 50. The Company's ECOSS and its use of the MDM study enjoy the support of prior Commission Orders and should not be modified now. Moreover, Staff supports the Company's use of the A&P ECOSS methodology in conjunction with the Company's MDM study. Staff Init. Br. at 74-75.

Despite prior Commission Orders, IIEC proposes to reallocate volume-related costs in the ECOSS based upon the peak day main size allocation factors from the Company's MDM study. Rosenberg Dir., IIEC Ex. 1.0, 6:107-7:129. IIEC's criticism of the Company's ECOSS and its proposed main size allocation modification are self-serving. Its proposal is admittedly flawed and not yet fully studied. Rosenberg Reb., IIEC Ex. 2.0, 24:504-05. IIEC's untested proposal assumes that annual volume flows by main size and rate class are in the exact same proportion as peak-day volume flows by main size and rate class. Rosenberg Reb., IIEC Ex. 2.0, 24:499-509.

Despite its shortcomings, IIEC encourages the Commission to approve its proposal because it contends its reallocation is "approximately right." *Id*. However, IIEC's Initial Brief fails to cite to any Commission Order adopting the use of its main size allocation methodology. To adopt IIEC's proposal requires the Commission to ignore how and why a MDM study is prepared. It also requires the Commission to ignore its 2004 Rate Case Order, which approved the exact same volume allocation methodology as proposed by the Company in this case.

The Company prepared its MDM study based upon a detailed analysis of peak-day gas flow by customer and by main size. It did not analyze annual volume flows by customer and main size, nor was it intended for that purpose. Mudra Sur. Corr., Nicor Gas. Ex. 48.0, 5:117-19. Further, the MDM study does not contain a direct measure of the distribution of annual volumes by size of pipe for each class. Heintz Sur., Nicor Gas Ex. 49.0, 4:77-78. 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. Mudra Sur. Corr., Nicor Gas. Ex. 48.0, 5:119-6:122. Additionally, residential customers have relatively low load factors as compared to industrial customers and, therefore, it is reasonable to assume that an allocation based upon peak-day volumes from the MDM study may be different than an allocation based upon annual consumption. *Id.*, 6:122-27.

No other party supports IIEC's proposal, and as set forth above, there is a good deal of uncertainty surrounding it. That uncertainty also should be considered in light of the impact it has on residential customers. IIEC's proposal shifts $8,300,000 in costs away from non-residential customers to residential customers. Mudra Sur. Corr., Nicor Gas. Ex. 48.0, 6:138-40. For the reasons described above, IIEC's proposal should be rejected and Nicor Gas' ECOSS should be approved.

While IIEC's proposal should be rejected at this time, Nicor Gas offers to review it and present its conclusions in the Company's next general rate case. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 4:85-88.

2. Allocation of Storage Costs to Unbundled Rate Classes

IIEC urges the Commission to change the way storage costs for Transportation customers (Rates 74, 75, 76, and 77) are developed. Specifically, IIEC recommends that Transportation customer storage costs be assigned based upon presumed Storage Banking Service revenues. Rosenberg Reb., IIEC Ex. 2.0, 19:403-05. No other party supports IIEC's proposal.

IIEC acknowledges that Nicor Gas has established the accuracy of its allocation methodology. IIEC Init. Br. at 10. Further, IIEC's Initial Brief fails to address the fact that Nicor Gas' allocation of storage costs employs the same methodology approved in the Company's last two rate cases.

The record is devoid of any persuasive evidence rebutting the accuracy of the Company's methodology. In a last ditch effort to save its proposal, IIEC speculates that the Company's methodology may prove less accurate after final rates are determined. IIEC Init. Br. at 10. However, there is no evidence which substantiates IIEC's claim. For the foregoing reasons, the Company's ECOSS should be approved.

D. Interclass Allocation Issues

1. Rate 1 Allocation

Nicor Gas balanced several major objectives when it designed its rates. Nicor Gas Init. Br. at 65. For example, the Company applied the rate making principle of gradualism. Gradualism considers the overall impact of the changes on a customer class while striving to achieve each of the Company's major objectives. In an effort to move the Rate 1 residential customer class closer to its cost of service, while employing the principle of gradualism, the Company proposes to allocate to the Rate 1 residential customer class 97.5% of its cost of service. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 10:222-26.

Nicor Gas' revenue allocation reflects directives from prior Commission Orders. In the 2004 Rate Case, the Commission concluded that it would be appropriate, "in the interests of gradualism," to limit the revenue requirement increase to the residential customer class (Rate 1). 2004 Rate Case, Order at 105. In that case, the increase to the residential customer class was limited to 95% of its full cost of service. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 10:222-26. Consistent with the Commission's gradualism approach, Nicor Gas proposes to move the residential customer class to 97.5% of its cost of service. Employing this gradualism approach to the residential customer class also is consistent with the Commission's application of this approach in the last three Peoples Gas rate cases. 2007 Peoples Rate Case, Order at 225.

Staff recommends approval of the Company's revenue allocation and further agrees the remaining revenues should be allocated to other non-residential rate classes based upon their percentage share of revenue requirements. Lazare Dir., Staff Ex. 7.0, 28:609-29:633, 30:649-53. AG/CUB does not oppose the Company's proposed residential customer class revenue allocation.

Only IIEC opposes the Company's Rate 1 residential customer class allocation. IIEC now proposes four different revenue allocation proposals in an effort to shift costs away from Rate 77 customers and on to residential customers. IIEC Init. Br. at 11-14. IIEC's first two alternatives require the Commission to disregard Nicor Gas' accurate ECOSS as well as prior Commission Orders. The last two alternatives, offered for the first time in IIEC's Initial Brief, are not supported in the testimony of IIEC's witness. Further, no other party supports IIEC's proposed interclass allocation alternatives.

IIEC proposes that the Commission immediately move all rate classes to their full cost of service, as well as use IIEC's proposed ECOSS modifications. IIEC Init. Br. at 11. This proposal eliminates any cross-subsidies between rate classes, which allocates an additional $12,000,000 to residential customers. For all the reasons set forth the in the Company's Initial Brief and this Reply Brief, IIEC's first proposal should be rejected. Nicor Init. Br. at 60-67.

IIEC's second alternative urges the Commission to approve an increase to all customer classes on a uniform across-the-board percentage if it finds that the Company's ECOSS is not valid. IIEC Init. Br. at 11-12, *citing* Rosenberg Reb., IIEC Ex. 2.0, 5-8. However, IIEC presents no reasonable basis for the Commission to reject the Company's ECOSS. Curiously, nowhere within the testimony that IIEC cites to in its Initial Brief does IIEC witness Rosenberg state that the Company's ECOSS is invalid. *Id*. Like IIEC's first proposal, this alternative requires the Commission to ignore the Company's accurate ECOSS, and to disregard its previous Orders. This alternative should also be rejected.

IIEC's third alternative is that if gradualism is employed for the benefit of Rate 1 customers, the same principle should be applied to Rate 77 customers. IIEC Init. Br. at 12-13. IIEC fails however, to distinguish why this case is different from any other Commission rate case where interclass subsidies have been approved. As in the 2004 Rate Case, the Company proposes to moderate the rate increase for residential customers. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 10:222-26. IIEC's request that gradualism also should be approved for Rate 77 large-volume industrial customers is unnecessary and should be rejected.

If gradualism is employed for Rate 1 residential customers, IIEC's fourth alternative suggests that recovery of the Rate 1 revenue shortfall be limited to Rates 4 and 74. IIEC Init. Br. at 13-14. IIEC offers no citation to the record supporting this alternative. IIEC argues that only non-residential Rates 4 and 74 customers should bear the burden of the revenue shortfall.

However, IIEC fails to explain why all other non-residential customer classes, Rates 5, 75, 6, 76, 7 and 77, should be excluded from bearing their proportionate share of the revenue shortfall.

Nicor Gas' residential customer class allocation rationally applies the principle of gradualism. Its allocation is consistent with the Commission's Order in the 2004 Rate Case and the last three Peoples Gas rate cases. 2004 Rate Case, Order at 105; 2007 Peoples Rate Case, Order at 225. The Company's proposal further narrows the interclass subsidy gap between residential and non-residential customers, and then proportionally allocates the shortfall to all of the remaining non-residential customer classes. Furthermore, Nicor Gas proposes to fully eliminate the residential interclass rate subsidy in its next general rate case. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 7:133-34. For the foregoing reasons, the Commission should approve Nicor Gas' Rate 1 revenue allocation.

VIII. RATE DESIGN

A. Overview

Nicor Gas incorporates herein the discussion of the Overview from Subsection VIII.A. of its Initial Brief. In contrast to Nicor Gas' rate design that results in rates that are just and reasonable, opposing parties' rate design proposals ignore cost-causation and/or exacerbate deficiencies within existing rate design. They propose to recover more costs on a volumetric basis, despite the fact that Nicor Gas' cost of service is largely fixed.

Nicor Gas' proposed rate design sets charges in a fashion that provides Nicor Gas a reasonable opportunity to recover its revenue requirement. Nicor Gas demonstrated that its rate design is consistent with its stated goals, prior Commission Orders. Nicor Gas Init. Br. at 67-79.

B. Uncontested Issues

1. Rate 6 and Rate 76 Design

Nicor Gas incorporates herein the discussion of the uncontested issue, Rate 6 and Rate 76 Design from Subsection VIII.B.1 of its Initial Brief.

C. Contested Issues

1. Rate 1 Design

(a) Overview

As discussed in detail in its Initial Brief, Nicor Gas proposes two primary changes for its Rate 1 customer class: (1) increase the Monthly Customer Charge to $13.55; and (2) reduce the amount of distribution rate blocks from three to two by eliminating the existing second block. Nicor Gas Init. Br. at 68-75; Mudra Dir. Corr., Nicor Gas Ex. 14.0, 17:385-18:402. With its requested rate design, Nicor Gas' proposed Monthly Customer Charge would remain lower than Ameren IP, Ameren CIPs, Ameren CILCO and Peoples Gas. Nicor Gas Init. Br. at 69. Moreover, the Company's proposed overall volumetric rates are lower than its existing rates. *Id*. at 70. The Company's rate design results in rates that are just and reasonable, and should be approved.

The fundamental disagreement between the Company and Staff relating to the Monthly Customer Charge concerns fixed charges. Staff argues that certain fixed, non-volumetric costs (demand costs) should not be recovered through fixed charges. The Company contends that these costs are properly recovered through fixed charges.

Staff witness Lazare's testimony is the basis for Staff's proposed rate design. Mr. Lazare offers a novel constraint on what types of fixed costs should be recovered through the Monthly Customer Charge. Lazare Dir., Staff Ex. 7.0, 40:867-68. Mr. Lazare's proposal would result in the Company being required to recover more fixed costs through volumetric charges. In addition, assuming Rider VBA is approved, Mr. Lazare's proposal would leave 87.5% as the percentage of fixed costs ("PFC") as used within Rider VBA, still embedded within volumetric charges. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 13:280-89. Mr. Lazare's alternative rate design proposal contradicts the Commission's prior Orders that approved the recovery of more fixed costs, like fixed demand and distribution mains costs, through a volumetric rate design.

Meanwhile, the AG proposes an "across-the-board" modification to residential rates. AG Init. Br. at 20. The AG alleges that Nicor Gas over-recovers from residential customers its fixed costs, and that low use customers are disproportionately harmed. AG Init. Br. at 20-21. As described in detail below, the AG's rate design proposal suffers from the same infirmities as Staff's, and should be rejected.

(b) Opposition to Nicor Gas' Proposed Rate Design

(i) Response to Staff

Staff witness Lazare claims there are disadvantages to Nicor Gas' Rate 1 rate design. *See* Lazare Dir., Staff Ex. 7.0, 40:867-68, 42:916-19. Mr. Lazare's claims are unpersuasive for several reasons.

(a) Nicor Gas' Rate Design is Consistent with Energy Efficiency

Staff contends the Company's proposed rate design reduces ratepayers' incentive to conserve. Staff Init. Br. at 79. By recovering a greater share of costs through a Monthly Customer Charge, Staff claims ratepayers are less able to achieve savings under the Company's rate design. *Id*. at 88-89. In support of its contention, Staff relies upon the 2006 National Action Plan for Energy Efficiency ("Report"). *Id*. at 86.

First, Staff selects quotes from the Report that cannot be reconciled with the real world experience of Nicor Gas and its customers. Staff states that

> with respect to *electricity* use that as a result of declining block rates, '*electricity* demand is more likely to increase, which could lead to long-term higher rates and bills…'

Staff Init. Br. at 86, *quoting* Report at 5-2 (emphasis provided). Based on this quoted passage discussing *electricity* demand Staff assumes that a declining block rate structure for natural gas also is more likely to increase demand. *Id*. at 86. Therefore, Staff concludes that Nicor Gas' declining block rates somehow are not consistent with energy efficiency goals. *Id*. Staff is wrong.

Nicor Gas's rate design currently utilizes declining block rates, yet contrary to Mr. Lazare's claim, per customer usage under declining block rates has been declining since at least 1996. Hawley Dir., Nicor Gas Ex. 1.0, 11:219-13:243. This is precisely the reason why the Commission should not rely on a quote addressing electricity demand to re-engineer natural gas distribution rates.

Mr. Lazare relies on the Report also as support for his claim that declining block rates reduce savings that customers can attain through energy efficiency. Staff Init. Br. at 90. However, a more complete analysis of the Report, would have demonstrated that declining rate block structures can promote efficiency. Lazare Dir., Staff Ex. 7.0, 36:796-99, *citing* http://www.epa.gov/cleanrgy/energy-programs/napee/resources/action-plan.html, Ch. 5, p. 5, fn. 1. The foundation upon which Mr. Lazare builds his contention is contrary to reality.

Second, reducing Nicor Gas' ability to recover its fixed costs through a low Monthly Customer Charge, as Staff proposes, forces the Company to be more dependent on the sale of greater volumes in order to recover its costs. Such a rate design creates a financial disincentive to promote energy efficiency. Mudra Reb. Corr, Nicor Gas Ex. 29.0, 13:260-75. Contrary to Staff's mischaracterization of the Company's position at page 91 of its Initial Brief, Nicor Gas has not requested an incentive to promote energy efficiency, but rather requests the Commission reduce the disincentive.

Finally, Staff complains that the Company's rate design may thwart energy efficiency investment because there may be less opportunity for savings. Staff Init. Br. at 91. Staff fails to recognize that commodity costs far outweigh delivery costs. Of the total typical residential customer's bill, 80% of the bill relates to the cost of the commodity, while only 20% is related to delivery charges. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 19:407-20:410. To place this in perspective, natural gas commodity costs are approximately 16 times greater (at $.85 per therm) than Nicor Gas' volumetric distribution charges (at $.0519 per therm). Mudra Reb. Corr, Nicor Gas Ex. 29.0, 19:404-20:410. Consequently, Staff's claims on this point are over-reaching. Under the Company's rate design, ratepayers will continue to enjoy significant opportunities to reduce their overall natural gas bill either by implementing energy efficiency options or by conserving.

(b) Nicor Gas' Rate Design is Consistent with its Goal of Developing Cost-Based Rates

Staff claims that the Company's rate design is inconsistent with its goal of creating cost-based rates. Staff Init. Br. at 79-83. Staff also alleges that residential customers with different sized homes cause different costs and that the Company's rate design is inconsistent with its revenue allocation methodology. *Id*. at 80. Staff is wrong.

Staff witness Lazare assumes that because the Company's proposed Monthly Customer Charge includes distribution main costs, customers in different sized homes should not have the same Monthly Customer Charge. Lazare Dir., Staff Ex. 7.0, 37:811-15. He claims that larger homes could be expected to use a larger amount of main capacity. *Id*. He offers no support for this claim other than speculation.

The Company rebutted Mr. Lazare's conjecture. Nicor Gas demonstrated that non-volumetric costs such as distribution main costs are by their nature fixed. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 14:318-15:332. As such, including costs which are non-volumetric within the fixed Monthly Customer Charge is perfectly consistent with cost causation principles. The Company also has shown, and no party has refuted, that of all Rate 1 customers, 90% are serviced by a two inch or less diameter main. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 15:303-07, 17:352:Table 2. Because nearly all Rate 1 customers are served by the same size distribution main, for rate design purposes, it does not matter whether a house is 1,000 sq. ft. or 4,000 sq. ft. This evidence clearly refutes Mr. Lazare's unfounded speculation.

Finally, Staff claims there is an internal inconsistency within the Company's position to include fixed demand charges within the Monthly Customer Charge because it had previously supported the Coincident Peak ("CP") method in prior proceedings. Staff Init. Br. at 81. To be clear, the Company utilizes in this case the use of the A&P method, not the CP method. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 7:161-64. Despite the Company's use of the Staff supported A&P method, Staff witness Lazare theorizes that because the Company also has acknowledged its support for the CP method, its use of the SFV rate design conflicts with its "beliefs" concerning cost causation for distribution costs. Lazare Dir., Staff Ex. 7.0 37:818-38:829. Mr. Lazare then concludes, based on the Company's "belief" in prior dockets that, its current rate design should be rejected. Mr. Lazare's illogical rate design position requires the Commission to ignore the fact that 94% of the residential cost of service is fixed, as developed under the A&P method. *See* Mudra Reb. Corr., Nicor Gas Ex. 29.0, 10:205-09. A Monthly Customer Charge based on a SFV rate design is consistent with the nature of recovering fixed distribution mains costs from its residential customers. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 16:321-25. Nicor

Gas' rate design is consistent with its goal of creating cost based rates, it is just and reasonable and it should be approved.

(c) Nicor Gas' Rate Design is Equitable

Staff claims that Nicor Gas' rate design is unfair to low-use residential customers because those customers would be required to pay the same Monthly Customer Charge as large-use residential customers despite their smaller contribution to these costs. Staff Init. Br. 83. In short, Staff assumes it costs less to serve low-use customers. *Id*. Staff's position fails to recognize that regardless of the amount of gas usage, 95% of all residential service lines were one of three sizes, with small, medium and large customers using approximately the same size lines in equal proportions. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 16:336-17:357. Nicor Gas has demonstrated its rate design is equitable to all residential customers.

(d) Nicor Gas' Rate Design Places Less Financial Stress on its Ratepayers than Competing Rate Design Proposals

Staff asserts the Company's Monthly Customer Charge proposal makes it difficult for ratepayers to achieve savings by reducing consumption, and therefore makes it difficult for ratepayers who are under financial distress to control their natural gas costs. Staff Init. Br. at 83. Staff's concern is misplaced and should be rejected because (1) Nicor Gas clearly has demonstrated that ratepayers will be able to achieve significant savings by reducing energy consumption through avoiding or reducing natural gas commodity costs, (2) the Company's rate design reduces the volatility of bills and sends more accurate delivery service price signals, and (3) Staff's proposal fails to fully consider the adverse impact of higher volumetric delivery charges on the Company or its customers.

As discussed above, natural gas costs comprise nearly 80% of a typical residential customer's total bill. Customers can directly impact 80% of their bill by reducing the amount of natural gas they consume. Reducing consumption under the Company's rate design proposal can yield significant economic value to ratepayers.

Second, the Company's rate design proposal will serve to flatten out delivery charges, thereby reducing the volatility in those charges that would occur during winter months. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 12:252-55.

Lastly, Staff's assertion is misplaced because it implies that the recovery of a utility's fixed costs should be more within the control of customers (regardless of financial ability) and more dependent on volumetric usage. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 20:411-20. Staff's proposal would allow customers to avoid paying for fixed costs at the expense of the Company. Such a proposal has recently been rejected by the Commission:

> In the final analysis, we are simply unable to approve only those measures that benefit ratepayers and wholly ignore what the impacts of these benefits will have on the Utilities. To do so could well be unlawful as this Commission is put to the obligation of balancing both the interests of consumers and the interests of the Utilities. See BPI, 146 Ill. 2d 175, 208 (1991) (stating that the Commission is charged with setting rates which are just and reasonable not only to the ratepayers but to the utility and its shareholders).

2007 Peoples Rate Case, Order at 152. Staff's opposition is patently one-sided and fails to adequately consider the negative impact the avoidance of fixed cost recovery will have on the Company. Nicor Gas' proposed rate design is just and reasonable and should be approved.

(e) The Company's Rate Design is Consistent with Prior Commission Orders

The Company's rate design which seeks to recover more of its fixed costs of service, including demand costs, through its Monthly Customer Charge, is consistent with prior Commission Orders. Nicor Gas Init. Br. at 70. Further, in its prior Orders, the Commission has recognized the heightened need for utilities to recover their fixed costs in an environment where per customer usage is declining. *Id*. Nicor Gas incorporates herein its discussion of prior Commission Orders from Subsection VIII.C.1.b of its Initial Brief. Nicor Gas Init. Br. at 70-72.

Staff acknowledges that recent Commission decisions have favored the recovery of demand costs in customer charges. Staff Init. Br. at 85. Despite its acknowledgment, Staff witness Lazare calls into question the Commission's wisdom in doing so. *Id.*, citing Lazare Dir., Staff Ex. 7.0, 31-42. Interestingly, Staff relies on past Commission practice to support its positions when it suits its need, but disavows prior Commission Orders when they are at odds with its proposed new rate design position which limits fixed cost recovery. *See* Staff Init. Br. at 72.

In an attempt to distance itself from the Commission's prior Orders, Staff witness Lazare claims there now exists a "substantial body of evidence" and that the Commission erred when it approved the recovery of more fixed costs in the 2007 Peoples Rate Case and 2007 Ameren Rate Case. According to Staff, that substantial body of evidence can be found within 12 pages of Mr. Lazare's direct testimony. Staff Init. Br. at 85 *citing* Lazare Dir., Staff Ex. 7.0, pp. 31-42. Examining these 12 pages, four and half pages either repeat the Company's position or refer to the Company's variable or distribution rates and do not apply to Monthly Customer Charges. Of the remaining seven and half pages, the only external source relied upon by Mr. Lazare was the 2006 Environmental Protection Agency's Report. The Report is not new. It was in existence prior to the time the Commission entered its Orders in the 2007 Peoples Rate Case and the 2007 Ameren Rate Case. And, the Report actually supports the Company's position.[12] Meanwhile,

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[12] The Report acknowledges that "regulators must balance competing goals in designing rates. http://www.epa.gov/cleanrgy/energy-programs/napee/resources/action-plan.html, Ch. 5, p. 2. The Report also acknowledges the primary function of rates is to allow utilities to collect their revenue requirement. *Id*. The Report also confirms what Nicor argues in this docket, and what the Commission approved in the 2007 Peoples Rate Case and the 2007 Ameren Rate Case, that "the majority of utility costs do not vary with changes in customer usage level" and consequently the "customer charge has a strong theoretical basis." *Id*.

the remaining “substantial body of evidence” is Mr. Lazare’s conjecture. His testimony provides no basis for the Commission to alter the Commission’s recent conclusions.

(ii) Response to AG

The AG makes four claims to support modifying the Company’s proposed rate design. None of these claims are reasonable. As discussed below, each claim should be rejected.

First, AG witness Rubin claims that “rather than simply increasing each rate element by the same percentage… Nicor is proposing a fairly radical restructuring of the rate.” Rubin Add. Dir., AG/CUB 3.0, 2:43-45. In reality, it is the AG’s recommended rate design that is radical.

Nicor Gas’ rate design is far from radical. Rather, it is derived from its cost of service study and consistent with cost causation principles and the rate designs approved by the Commission in the 2007 Peoples Rate Case and the 2007 Ameren Rate Case. Nicor Gas incorporates herein the discussion of the Commission’s recent decisions contained in its Initial Brief and this Reply Brief. Nicor Gas Init. Br. at 70-72. In the 2007 Ameren Rate Case, in approving recovery of a greater proportion of fixed costs in a monthly customer charge, the Commission stated:

> [a]n alternative to Rider VBA that would still promote fixed cost recovery by the utility is recovery of a greater proportion of fixed delivery costs through the fixed monthly customer charge to all affected customer. AIU makes this suggestion and notes that under this method, utilities could not over-or under-recover their Commission-approved base rate revenue requirement with changes in sales. AIU adds that this alternative would also send proper price signal to customers. The Commission concurs with these statements and notes further that this alternative arguably decreases any disincentive AIU may perceive to implementing gas efficiency programs.

2007 Ameren Rate Case, Order at 237.

It is absurd to suggest that Nicor Gas' proposed Monthly Customer Charge of $13.55, one that is lower than four other major Illinois gas utilities, and only a nickel more than North Shore Gas, can be considered "radical." Nicor Gas Init. Br. at 69. Moreover, Nicor Gas' proposed distribution charges *decrease* the charge for the first 20 therms, eliminates the existing second block and ultimately reduces its rate and maintains the existing charge for a new tail-block for all use above 20 therms. *Id*. at 70.

The AG does not cite to any Commission Order or case law to support its baseless claim. Neither does the AG address the recent Commission Orders approving rate designs similar to the one proposed by Nicor Gas. It appears, rather, that the AG chooses to ignore prior Commission decisions.

Second, the AG claims the Company's rate design is unnecessary because its current rate design allows the Company to recover its fixed costs. Specifically, the AG states that Nicor Gas claims it is not "recovering its fixed costs through its existing rate design…." AG Init. Br. at 20. The AG mischaracterizes the Company's position and provides no citation for this purported claim. Nicor Gas does not suggest that its current "rate design" fails to recover fixed costs. Rather, Nicor Gas' current and proposed rate design is intended to provide the Company with an opportunity to recover its revenue requirement. Nicor Gas' proposed rate design only provides it an opportunity to recover a larger proportion of its fixed costs through the fixed Monthly Customer Charge as the evidence demonstrates that the vast majority of its customer costs are fixed. The Commission should reject the AG's mischaracterization of the Company's position.

Third, the AG claims the Company's proposed rate design unreasonably impacts the bills of low-use customers. AG Init. Br. at 20. AG witness Rubin opposes Nicor Gas's cost-based rates because low-use customers' monthly percentage increase is more than other users.

Specifically, when complaining of the percentage increase for low-use customers, Mr. Rubin focuses on the smallest 0.21% of Nicor Gas' non-heating customers, who use on average just 11 therms per year. Rubin Reb., AG/CUB Ex. 5.0, 2:25-26. The Commission should not be swayed by Mr. Rubin's use of percentages without first considering the actual dollar impact on customers.

In fact, the dollar increases for all residential customers is very similar. The increase for the smallest use non-heating customers equals $5.13 per month. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 20:439-21:443. To put this in perspective, all other non-heat customers would receive a similar increase per month, ranging from $4.57 to $5.00. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 12: 241-42. Similarly, while the smallest 3.97% of space heating customers would receive a monthly increase of $4.78, all other heat customers would receive monthly increases between $4.57 and $4.69. *Id*. These monthly cost variations not in any way result in disparate billing impacts and certainly are not extreme as claimed by Mr. Rubin.

The AG further complains that Nicor Gas' proposed monthly customer charge penalizes low-use customers. AG Init. Br. at 23. This complaint evidences either the AG's lack of understanding of cost-based rates or its indifference to cost-based rates. The AG refuses to acknowledge that both low and large volume residential customers contribute to Nicor Gas' fixed costs and share access to similar distribution facilities. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 16:340-17:357. Nicor Gas' rate design would serve to reduce any existing *intra*-class subsidy that currently exists between low use and high use customers. Moving customers closer to their cost of service is not a penalty, it is good rate design. Nicor Gas' proposal to recover more of its fixed costs through a fixed charge reduces any existing *intra*-class Rate 1 subsidy claimed by the AG, whereas the AG's proposal would perpetuate and exacerbate the *intra*-class

Rate 1 subsidies. Consequently, it is not Nicor Gas' proposed rate design that, "unfairly increases inequities within the residential class…" as alleged by the AG, but the AG's own rate design proposal that maintains and expands *intra*-class subsidies without regard for the magnitude of the actual dollar impact that it will have on other residential customer bills. AG Init. Br. at 24.

Although the AG opposes SFV rate design, it acknowledges that a SFV rate design would allow the Company an opportunity to recover all fixed costs through the customer charge, with recovery of variable costs implemented through a very low per-therm distribution charge. AG Init. Br. at 24. The thrust of the AG's opposition, like its opposition to the Company's proposed monthly customer charge, is that some customers will proportionally pay more than they do today. However, the AG's position neglects to address cost causation principles. Furthermore, the Company has considered rate impacts and in response has proposed the use of gradualism and improved its rate design, with the deliberate purpose of gradually moving toward a more effective means of recovering the fixed cost of providing natural gas delivery service now and into the future.

Moving toward a SFV rate design will reduce the *intra*-class subsidies that exist today while improving the residential rate design. The Company's proposed rate design, is cost-based, is just, fair and reasonable for all customers.

(c) Proposed Revisions

(i) Staff

Staff proposes that monthly customer charges only recover a limited portion of the Company's total fixed costs, as determined by the ECOSS. Lazare Dir., Staff Ex. 7.0, 40:867-68. The Commission has approved the recovery of more fixed costs in a monthly customer charge, not less as proposed by Mr. Lazare. 2007 Ameren Rate Case, Order at 237.

Nicor Gas incorporates herein the discussion of this issue from Subsection VIII.C.1.c of its Initial Brief. Further, instead of limiting the recovery of costs through the Monthly Customer Charge, the Commission has authorized the recovery of more fixed costs through fixed charges. 2007 Peoples Rate Case, Order at 250-53. Nicor Gas' proposed rate design builds upon what the Commission approved in the 2004 Rate Case and follows recent Commission rulings. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 9:188-90.

Second, Mr. Lazare recommends that Nicor Gas replace its declining-block rate structure with a flat distribution structure, one that would result in a flat distribution charge for Rate 1, as well as Rate 4 and Rate 74. Lazare Dir., Staff Ex. 7.0, 42:915-17. Mr. Lazare also proposes an alternative declining block rate design in the event the Commission does not accept his flat distribution rate design. *Id*., 42:927-43:934.

Mr. Lazare's flat distribution rate proposal exposes ratepayers and Nicor Gas alike to greater exposure to weather volatility. When compared to the Company's proposed volumetric rates, Mr. Lazare's flat distribution rate is approximately twice as high for therms consumed in excess of 20 therms per month. Lazare Dir., Staff Ex. 7.04, p. 1; Nicor Gas Init. Br. at 70. As such, during cold weather, when usage is at its greatest, ratepayers' delivery bills will increase as compared to the Company's declining block rates. Nicor Gas witness Mudra has made Mr. Lazare aware of the effect of his proposal, yet Mr. Lazare refuses to modify his position. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 10:214-15. Staff's insensitivity to high winter bills is reflected in its Initial Brief where it supports the notion that high winter bills are good for conservation. Staff Init. Br. at 88. It is poor policy to establish higher distribution charges for the purpose of encouraging conservation. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 13:265-75.

Raising volumetric delivery rates artificially to encourage reduced demand is inconsistent with cost of service, is poor rate design and should be rejected.

Staff's contention that its rate design proposal would better incent energy efficiency is puzzling. Staff contends that under its rate design proposal if an average residential customer reduces its consumption by 100 therms per year, it would save $4.71 more than under Nicor Gas' rate design. Staff Init. Br. at 91-92. However, the Company has shown that under its rate design proposal, that same customer would still save approximately the same amount. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 18:378-19:394. Staff provided no analysis indicating the saving achieved under the Company's rate design would impair customers from pursuing energy efficiency. Moreover, Staff's saving argument assumes therm reductions. In concert with its rate design proposal and Rider VBA, the Company proposes a voluntary energy efficiency plan as a tool for ratepayers to reduce consumption. The Company's comprehensive proposal makes increased energy conservation even more realistic. Staff's opposition to the Company's voluntary energy efficiency plan, makes its annual savings purely hypothetical.

Lastly, while the Company's proposal will help to flatten customers bills, Staff witness Lazare's proposals exacerbate the impact of cold weather on customers' bills. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 10:212-15. Staff's proposals perpetuate the yo-yo effect between winter and summer bills. The volatility resulting form Staff's proposals run counter to the Commission's statement that recovering more fixed costs through fixed charges would "also send proper price signal to customers" (2007 Ameren Rate Case Order at 237) and, therefore, the proposals unreasonable.

Nicor Gas opposes Mr. Lazare's rate design proposals because they would increase winter bills, decrease summer bills and increase the Company's exposure to weather. Mudra

Reb. Corr., Nicor Gas Ex. 29.0, 10:212-15. For these reasons, the Commission should reject Staff's proposed flat distribution rates.

(ii) AG/CUB

The AG recommends the use of an across-the-board increase to residential customers' rates. AG Init. Br. at 20. The AG's Initial Brief is devoid of any support for its particular proposal. The AG proposes increasing all Rate 1 charges (monthly customer charge and each of the three existing volumetric distribution charges) by the same percentage increase as approved for Rate 1 in this proceeding. Rubin Add. Dir., AG/CUB Ex. 3.0, 18:374-19:388.

Nicor Gas opposes the AG's proposed rate design for several reasons. First, the AG's oversimplified rate design fails to recognize the importance of the recovery of fixed costs through fixed monthly customer charges. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 12:247-49. Though the AG does not oppose the Company's ECOSS, its across-the-board increase ignores cost causation. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 18:390. The AG's failure to adequately reflect the fixed cost of service in a monthly customer charge requires its proposal be rejected.

Moreover, by increasing the tail block, the AG's rate design exacerbates weather sensitivity by increasing residential bills in winter months when usage is at its highest instead of leveling out customer delivery charges as provided through Nicor Gas' proposed rate design. *Id.*, 12:252-55. The volatility created by and potential to exacerbate high winter bills, make the AG's proposed volumetric charges unreasonable.

For these reasons, the Commission should reject the AG's proposed across-the-board residential rate design.

2. Conservation and Rate 1 Design

Nicor Gas incorporates herein the discussion of this issue from Subsection VIII.C above and Subsection VIII.C.2 of its Initial Brief.

3. Rate 1 - Alternative Straight Fixed Variable Design

Nicor Gas incorporates herein the discussion of this issue from Subsection VIII.C above and Subsection VIII.C.3 of its Initial Brief..

4. Rate 4 and Rate 74 Design

(a) Overview

Nicor Gas incorporates herein the Overview discussion from Subsection VIII.C.4.a of its Initial Brief.

(b) Staff's Alternative

Staff proposes a smaller Monthly Customer Charge and a flat distribution structure that would result in a flat distribution charge for Rate 4, and Rate 74. Staff Init. Br. at 93. Nicor Gas opposes Staff's proposal. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 10:212-15. Staff's proposed rate design adopts the same flawed rationale as its Rate 1 rate design.

Staff's flat distribution rate fails to adequately consider that customers served under Rates 4 and 74 are not homogenous. Mudra Reb. Corr, Nicor Gas Ex. 29.0, 20:422-31. These customers range in size from very small store front companies using 30 therms a month to large manufacturers using 65,000 therms a month. *Id*., 20:431-21:433. To reflect the differences between theses customers, the Company uses three different levels of Monthly Customer Charges based upon meter size. *Id*., 21:433-35. Staff fails to account for these unique differences between customers. Its one-size-fits-all rate design proposal is unreasonable and should be rejected.

The Commission considered similar Staff proposals in the 2004 Rate Case and properly rejected them. 2004 Rate Case Order at 156. Staff neither points to a change in circumstance nor presents any additional evidence showing the Commission erred in the 2004 Rate Case. Though Staff asserts that it has provided "meaningful evidence" in support of its proposal it provides no citation to this evidence. Staff Init. Br. at 94. In contrast, the Company's rate design for Rates 4 and 74 accurately reflects customer load profiles and will provide Nicor Gas a reasonable opportunity to recover its revenue requirement. *Id*., 21:435-37. Accordingly, Nicor Gas' proposed rate design for Rates 4 and 74 should be approved by the Commission as just and reasonable.

5. Rate 5 and Rate 75 Design

(a) Overview

Nicor Gas incorporates herein the Overview discussion from Subsection VIII.C.5.a of its Initial Brief.

(b) Annual Therm Limitation

Though Staff continues to support increasing the annual therm limit use for Rates 5 and 75 from 250,000 therms to 1.5 million therms, which it adopted from Vanguard's original proposal, Staff no longer objects to the annual therm limitation agreed to by Nicor Gas and Vanguard. Staff Init. Br. at 96. Nicor Gas and Vanguard agreed to limit the annual therm cap for Rates 5 and 75 to 700,000 therms. Nicor Gas Init. Br. at 78.

Staff now contends that when developing its final rates for Rates 5 and 75, the Company should be ordered to assume a 10% customer subscription rate. Staff Init. Br. at 96. Staff's recommendation is based upon the current subscription rates for therm level limitations of 250,000 therms. *Id*.

The Company opposes Staff's customer subscription rate proposal because it places the Company in jeopardy of not recovering its costs. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 22:471-23:478. Staff's recommendation fails to consider that raising the therm limitation expands greatly the universe of potential applicants and that both the number of expected applicants as well as the expected volume of therms delivered under Rates 5 and 75 must be properly estimated in the final rate design. *Id*. at 22:465-67. Staff did not support its subscription rate proposal with any formal study to determine the number of likely subscribers or the expected volumes. Rather, Staff speculates as to the new number of applicants and does not even consider the expected volume of therms that can be expected to switch from other existing rates to Rates 5 and 75. Staff Init. Br. at 96. An arbitrary customer subscription rate that also fails to consider volumes that can be expected to switch from other rates to the discounted Rates 5 and 75 must be rejected.

Staff's proposal surely will result in a misallocation of costs. Misallocation of costs is a fundamental shortcoming of expanded therm limitations and has been addressed in Subsection VIII.C.5.b of Nicor Gas' Initial Brief and is incorporated herein. Staff's proposal creates the potential of under recovery and disincents the Company to work with and expand its offerings to parties like Vanguard.

For rate design purposes, the Company proposes to utilize its undisputed test-year forecast of approximately 63 Rate 5 customers using 4,333,000 therms per year, and 22 Rate 75 customers using 3,650,000 therms per year, as shown on Nicor Gas Exhibit 48.3 for those eligible customers using less than the current annual limitation of 250,000 therms per year. The Company asserts this is roughly equivalent to Staff's proposal of assuming a 10% customer subscription rate. In addition, the Company proposes that it is more realistic also to assume that all newly eligible, large-volume customers that use more than the existing 250,000 therm per year limit, but less than 700,000 therms per year, be included in the rate design. Because these newly eligible large-volume users will realize the greatest economic benefit from rate switching, and these customers regularly work with Transportation Suppliers in selecting their rates, it is realistic to assume that 100% of the larger volume users will switch to Seasonal Rates 5 and 75.

If the Commission approves the expanded therm limitation of 700,000 therms per year under Rates 5 and 75, it also should approve the use of Nicor Gas' existing Rate 5 and 75 billing determinates. This information is shown on Exhibit 48.3 for customers using less than 250,000 therms per year with the addition of 100% of the eligible customers using between 250,000 therms per year and 700,000 therms per year. This compromise, will reflect the continuation of the 10% subscription rate for the existing smaller-volume users but will also provide the Company with a more realistic opportunity to recover its costs than Staff's arbitrary proposal.

6. Rate 7 and Rate 77 Design

Nicor Gas set forth its Rate 7 and Rate 77 rate design proposal in Subsection VIII.C.6 of its Initial Brief and incorporates that discussion herein. Nicor Gas Init. Br. at 78-79.

Staff states its proposed Rate 7 and Rate 77 rates are based on the same principles that drive its rate design for residential and non-residential customers. Staff Init. Br. at 96-97. In the event the Commission rejects its rate design proposal Staff offers an alternative rate design that employs a declining block rate structure. Lazare Dir., Staff Exs. 7.04 and 7.06.

As discussed within Subsections C.1-4 of Section VIII this Reply Brief and the Company's Initial Brief, Staff's limited customer charge and flat distribution rate design proposal is unsound. Evidence of the infirmity of Staff's proposal is highlighted in its application to Rates 7 and 77. Under his proposal, Staff witness Lazare's rate design would increase the demand tail-block for Rate 77 customers by 1,000%. Nicor Gas Init. Br. at 79. If the Commission will not approve a 1,000% increase, Mr. Lazare has an alternative. Mr. Lazare's alternative proposal would increase the demand tail-block for Rate 77 customers by 533%. Staff's proposals for Rates 7 and 77 are unreasonable and should be rejected. Nicor Gas proposed rate design for Rates 7 and 77 should be approved.

IX. TARIFF REVISIONS AFFECTING TRANSPORTATION CUSTOMERS

A. Overview

Nicor Gas is permitted to recover its storage revenue requirement through a combination of its Sales service base rates, charges to Transportation customers and through Rider 5, Storage Service Cost Recovery. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 41:874-77. Nicor Gas' objective in this proceeding is simply to develop just and reasonable rates and to treat all of its customer classes fairly. As part of meeting this objective, Nicor Gas proposes to update certain charges and factors that relate to the Company's Transportation charges. Each of Nicor Gas' proposals should be approved as just and reasonable.

Staff recommends that the Commission approve each of the Company's proposals listed below as an uncontested issue. Staff Init. Br. at 99-101. However, with respect to the contested issues, Staff argues that "Nicor Gas' proposals ignore historical context and are inconsistent with the Commission's decision" in the 2004 Rate Case. *Id*. at 99. To the contrary, Nicor Gas' proposals follow the Commission's guidance in prior Orders wherever possible. For example, Nicor Gas uses the same basic method of calculating the Storage Banking Service charge as was approved in the 2004 Rate Case, which is to divide the storage revenue requirement (dollars) by the amount of storage capacity (Bcf). Mudra Reb. Corr., Nicor Gas Ex. 29.0, 37:789-92. Nicor Gas also uses the same method for calculating the Transportation customer's daily storage withdrawal right factor as was used in the 2004 Rate Case. *Id*., 45:938-46:970.

Accordingly, attempts by Staff and other parties to paint Nicor Gas' position as deviating from the Commission's Order in the 2004 Rate Case should be disregarded and the Commission should approve Nicor Gas' proposals to update the Transportation-related charges and factors, which are supported by the evidence and discussed in the Company's Initial Brief and below.

B. Uncontested Issues

1. Individual and Group Administration Charges

Nicor Gas incorporates herein the discussion of Individual and Group Administration Charges from Subsection IX.B.1 of its Initial Brief.

2. Recording Device Charges

Nicor Gas incorporates herein the discussion of Recording Device Charges from Subsection IX.B.2 of its Initial Brief.

3. Group Change Fees

Nicor Gas incorporates herein the discussion of Group Change from Subsection IX.B.3 of its Initial Brief.

4. Transportation Service Credit

Nicor Gas incorporates herein the discussion of Transportation Service Credit from Subsection IX.B.4 of its Initial Brief.

5. Gas Supply Cost / Demand Gas Cost

Nicor Gas incorporates herein the discussion of Gas Supply Cost / Demand Gas Cost from Subsections IX.B.5 and IX.C.2.c.i of its Initial Brief.

6. Timing of Maximum Daily Contract Quantity ("MDCQ")

Nicor Gas incorporates herein the discussion of Timing of MDCQ from Subsection IX.B.6 of its Initial Brief.

C. Contested Issues

1. Proposed Reductions in Nomination Rights

As explained in Nicor Gas' Initial Brief, a Transportation customer's Maximum Daily Nominations ("MDN") is the maximum amount of gas that a customer can nominate for delivery into Nicor Gas' system on a day and is applicable in the months of April through October. Nicor

Gas Init. Br. at 81. The MDN is currently calculated for each month, April through October, by adding (1) the customer's historical monthly usage for the month, and (2) 25% of the customer's Storage Banking Service ("SBS") capacity, with the resulting volume then converted to a daily rate by dividing it by the number of days in the month. *Id*.

Nicor Gas proposes to modify the second part of this calculation for the months of July through October by changing the storage injection quantity portion of a customer's MDN from 25% of a customer's SBS capacity to 25% of a customer's open capacity as of April 30th (the difference between the customer's capacity and the amount of gas in storage). *Id*. Nicor Gas also proposes to revise the MDN for the months of March and April, which are critical months for ensuring that Nicor Gas is operationally able to cycle gas in inventory. *Id*. at 83.

Nicor Gas presented evidence demonstrating why the proposed changes to the daily nomination limits are necessary, including, but not limited to:

- The Company's daily nomination limit proposals make sense from an operational perspective because they more closely match customers' storage utilization with actual storage field operating requirements. Bartlett Reb., Nicor Gas Ex. 19.0, 14:326-28.

- The proposed changes are expected to reduce the additional costs which Sales customers are forced to incur due to the storage usage patterns of Transportation customers. Bartlett Reb., Nicor Gas Ex. 19.0, 14:328-30; Nicor Gas Ex. 19.3.

- The proposed changes will help reduce the potential need for Nicor Gas to "cap" pipeline deliveries for those days on which too much gas is being nominated to Nicor Gas' system relative to the level of deliveries that can be physically accommodated by Nicor Gas' system consistent with sound storage field management. Bartlett Dir. Corr., Nicor Gas Ex. 4.0, 25:533-36, 29:617-18. Since Transportation customer nominations have not been at levels necessary for the Company to issue caps in recent months, then it is equally likely that any reduction in nomination limits would not impact customers. Bartlett Reb., Nicor Gas Ex. 19.0, 17:390-93.

Several parties claim that Nicor Gas' proposed changes are unnecessary. For example, Staff argues that, *inter alia*, Nicor Gas' proposals are too stringent on Transportation customers and Nicor Gas has not justified the size of its proposed reduction levels. Staff Init. Br. at 103-12. IIEC similarly argues that the new MDN limitations will diminish the flexibility of Transportation customers and that Nicor Gas purportedly has not demonstrated the need for the proposed restrictions. IIEC Init. Br. at 16-21. Finally, Constellation NewEnergy-Gas Division, LLC ("CNE") argues that the Commission should maintain the existing MDN tariff language because Nicor Gas' proposed modifications are unsupported and result in uncertainty in determining actual injection rights. CNE Init. Br. at 6-18.

In addition to these arguments, Staff, IIEC and CNE all attack Nicor Gas Exhibit 19.3, which was submitted in support of the Company's proposed MDN reductions, for a variety of reasons. Staff Init. Br. at 106-07; IIEC Init. Br. at 18-19; CNE Init. Br. at 11-13. The operational storage plan used in Nicor Gas Exhibit 19.3 is not some "hypothetical" ideal. Rather, it is a reasonable working plan that is implemented annually. Bartlett Sur., Nicor Gas Ex. 38.0, 29:652-57. Nicor Gas creates an optimal storage plan that includes daily, monthly, and seasonal activity needed to reach the seasonal inventory targets required to meet the multiple operating objectives discussed in Nicor Gas' testimony. *Id*. Moreover, Nicor Gas demonstrated that while actual storage activity will vary daily from the base plan due to weather and customer usage variations, Transportation customers' utilization patterns of Nicor Gas' on-system storage compared to the overall physical storage operating patterns clearly show that their activity also is linked to other factors, such as economic drivers. *Id.*, 30:666-69, 675-79.

Nicor Gas submits that its evidence more than amply supports the Commission's approval of the Company's proposed MDN reductions. However, based on post-hearing discussions, Nicor Gas and CNE have agreed upon a resolution of this issue. Nicor Gas agrees to withdraw its proposed change to MDN rights for July through October. As such, current nomination rights for those months will remain intact. The Company's withdrawal of it July through October MDN reduction proposal is contingent upon the Commission approving the agreed upon March and April MDN reductions and the agreed upon on-system storage capacity level. Nicor Gas and CNE agree that MDN rights for the month of March shall be equal to one times a customer's MDCQ. For the month of April, Nicor Gas and CNE agree a customer's MDN rights shall be equal to its historical usage for the month plus 8% of the customer's SBS capacity rights, converted to a daily rate by dividing by the number of days in the month. The agreement reached by Nicor Gas and CNE is reasonable and is supported by the record. The modifications to MDN rights for the months of March and April should be approved as agreed upon by Nicor Gas and CNE.

2. Storage Calculations

As discussed at length in its Initial Brief, Nicor Gas proposes changes to the SBS provisions in its tariffs for Transportation customers. Nicor Gas Init. Br. at 79-95. Each of the Company's proposed SBS calculations should be approved.

There are three SBS calculations in dispute, the central issue of which is the level of on-system capacity to allocate and utilize in each calculation: (1) SBS capacity or entitlement; (2) the SBS charge, and (3) SBS Critical Day withdrawal rights. Bartlett Sur., Nicor Gas Ex. 38.0, 20:443-46. Nicor Gas originally proposed using 134.6 Bcf in each of these calculations, which it contends is the operational non-coincidental maximum capacity for the storage fields. *Id*.. 25:563-65.

Staff, CNE and IIEC raise numerous arguments about Nicor Gas' proposed changes to the SBS provisions. Staff Init. Br. at 112-22; CNE Init. Br. at 18-35; IIEC Init. Br. at 21-28. Among the complaints raised is that Nicor Gas uses different terms for referring to the 134.6 Bcf figure used in the Company's calculations. Staff Init. Br. at 113-14; CNE Init. Br. at 26-27; IIEC

Init. Br. at 22. The simple fact is that while Nicor Gas tries to cycle all of its operational capacity, it cannot do so for the numerous reasons listed in testimony and in Nicor Gas' Initial Brief. *See* Bartlett Reb., Nicor Gas Ex. 19.0, 12:263-14:315; Bartlett Sur., Nicor Gas Ex. 38.0, 20:443-28:640; Nicor Gas Init. Br. at 85-90.

Staff and IIEC recommend that the Commission order Nicor Gas to base all three SBS calculations on 149.7 Bcf, which is purportedly the Company's peak non-coincident working gas storage capacity. Staff Init. Br. at 112; IIEC Init. Br. at 21. CNE originally proposed all three SBS calculations be based on 149.7 Bcf as well. CNE Init. Br. at 6, 21. The 149.74 Bcf figure is improper for a number of reasons. *See* Bartlett Sur., Nicor Gas Ex. 38.0, 20:456-21:471; Nicor Gas Init. Br. at 85-88. Nicor Gas submits that its proposed test year inventory level of 134.6 Bcf is an appropriate level of capacity to used in the three SBS calculations because the level of inventory that supports all of the Company's objectives, which include allowing complete or nearly complete cycling of top gas inventory and covering daily peak withdrawal targets. Bartlett Sur., Nicor Gas Ex. 38.0, 20:456-21:471.

Further, Staff and IIEC point to the Order in the 2004 Rate Case as supportive of their position. Staff Init. Br. at 112-17; IIEC Init. Br. at 21. However, Nicor Gas' proposal is consistent with the Commission's determination in the 2004 Rate Case that non-coincidental capacity, and not cycling, should be used. 2004 Rate Case, Order at 120. The Commission recognized in the 2004 Rate Case that the calculation of the SBS charge is dependent upon the related issue of Storage Capacity Allocation to Transportation customers. 2004 Rate Case, Order at 138. Therefore, before the proper SBS charge can be computed, the total amount of available storage capacity to allocate must be accurately established. Quite simply, that is all Nicor Gas has tried to do with its proposal of 134.6 Bcf.

As an alternative, CNE recommended the amount of 142.37 Bcf be adopted. CNE Init. Br. at 29. According to CNE its alternative capacity amount is derived using the four year non-coincident peak of Nicor Gas's storage fields. *Id*.; *see* CNE Ex. 1.4.

Finally, the Company's original on-system storage capacity proposal of 134.6 Bcf also is consistent with the actual non-coincidental inventory levels achieved over the past three years. Bartlett Sur., Nicor Gas Ex. 38.0, 21:476-77. Since the 2004 Rate Case, the total maximum non-coincident level of working gas in storage from 2005 to 2007 was 138.9 Bcf, 135.0 Bcf, and 134.1 Bcf, respectively. Staff Cross Ex. 3, DAS 7.18 (d). When compared to the immediately preceding three years, either individually or as a three year average (135 Bcf), the Company's 134.6 Bcf capacity proposal is more in line with its actual experience than any other party's proposal.

Although there has been much testimony and briefing on this issue, the ultimate outcome of the inventory level in this proceeding has no bearing on Nicor Gas' revenue requirement. In other words, the Company gains nothing and loses nothing no matter what the Commission decides. In reality, this issue is a matter of fairness between Nicor Gas' customer groups (Transportation customers, Customer Select customers, and Sales customers). If Transportation customers are granted more capacity than they are entitled to, then Sales customers are harmed. Nicor Gas' original on-system storage capacity proposal was intended to be fair to all customers.

Based on post-hearing discussions, Nicor Gas and CNE have, for settlement purposes only, agreed upon a resolution of this issue. Nicor Gas and CNE agree the on-system storage capacity level be set at 142.37 Bcf. Again, this agreement is contingent upon the Commission's acceptance of Nicor Gas' and CNE's agreed upon MDN resolution. The agreement reached by Nicor Gas and CNE is reasonable, is supported by the record and should be approved. As a result of this agreement, and with Commission approval, the calculation of the SBS capacity or entitlement; the SBS charge, and the SBS Critical Day withdrawal rights should reflect an assumed on-system capacity of 142.37 Bcf.

(a) Storage Banking Service ("SBS") Entitlement

The Company's original calculation of the Storage Capacity Allocation, or SBS entitlement, represented the equal number of peak days of on-system storage capacity available to all Nicor Gas' customers based on an available on-system capacity of 134.6 Bcf. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 38:819-27. Staff, CNE and IIEC argue that application of the formula adopted by the Commission in the 2004 Rate Case in this proceeding would raise the number of MDCQ of storage to 31 days. Staff Init. Br. at 117; CNE Init. Br. at 31; IIEC Init. Br. at 24. This figure is based on an assumed available on-system capacity of 149.7 Bcf. As discussed above in Subsection IX.C.2, in testimony, and in its Initial Brief, Nicor Gas properly computed that 28 peak days of storage capacity are available to all Sales, Customer Select and Transportation customers based upon the 134.6 Bcf. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 42:901-10; Nicor Gas Init. Br. at 85-87.

However, based on post-hearing discussions with CNE, the Company and CNE agree that the SBS entitlement be based on an assumed available on-system capacity of 142.37 Bcf. Accordingly, the Commission should approve an SBS Entitlement based on an assumed available on-system capacity of 142.37 Bcf. Based upon the agreement between Nicor Gas and CNE, the SBS entitlement should be set at 29 days. CNE Init. Br. at 29.

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

Nicor Gas originally proposed updating its SBS charge to $0.0042 per therm of storage capacity to reflect the current cost of servicing Transportation customers. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 24:526-38; Mudra Reb. Corr., Nicor Gas Ex. 29.0, 35:759-36:771, 36:786-

37:788. Staff and IIEC argue that the computation of the SBS charge should be based upon 149.7 Bcf of storage capacity, which would result in a $0.0038 per therm charge. Staff Init. Br. at 118-19; IIEC Init. Br. at 24-26. CNE originally argued the SBS charge should be based upon 149.7 Bcf as well. CNE Init. Br. at 31-33. As explained above in Subsection IX.C.2 above, the Commission should approve a computation for the SBS charge based upon an assumed 142.37 Bcf on-system storage capacity, as agreed upon by Nicor Gas and CNE.

(c) Storage Withdrawal Factor ("SWF")

Based upon the agreed upon on-system storage capacity of 142.37 Bcf, Nicor Gas and CNE agree that the SWF will be set at 0.018. Nicor Gas agrees that it will revise its tariff to utilize Staff's proposed "Storage Withdrawal Constant" term.

(i) Storage Withdrawal Constant ("SWC")

The Company proposes to update the SWC from .017 to .0182. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 29:645-48; Mudra Sur. Corr., Nicor Gas 48.0 Corr., 49:1057-62.

Staff recommends that the SWC remain at 0.017, because the inputs into the formula are purportedly unchanged since the 2004 Rate Case, or, in the alternative, that the SWC be set at 0.019 if determined based upon targeted inventory. Staff Init. Br. at 119-20. CNE argues that the Commission should reject Nicor Gas' proposed change because the formula is purportedly not the same as adopted in the 2004 Rate Case. CNE Init. Br. at 33-34.

While there are minor differences between the calculation method initially proposed by Nicor Gas and that used in the 2004 Rate Case, Nicor Gas simplified its proposal in surrebuttal testimony. As simplified, Nicor Gas' proposal will grant Transportation customers their full rights to withdraw approximately the same proportion of their peak day MDCQ as the Nicor Gas system can withdraw on a Critical Day. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 51:1098-1100, 51:1112-52:1116, 52:1132-53:1146; Fabrizius Reb., CNE Ex. 3.0, 23:491-99.

Should the Commission approve the assumed on-system storage capacity amount of 142.37 Bcf as agreed upon by Nicor Gas and CNE, the SWC would be updated from 0.17 to 0.176 and rounded to 0.018. Accordingly, the Commission should approve the Company's proposal to update the SWC.

(ii) Timing of the Storage Withdrawal Factor Calculation

IIEC proposes that the customer's Maximum Inventory Balance be determined between the period of October 15th and November 15th as opposed to the determination occurring exactly on November 1st. IIEC Init. Br. at 26-28. CNE joins in IIEC's proposal. CNE Init. Br. at 34-35. Nicor Gas opposes this recommendation for the reasons discussed in testimony and its Initial Brief. Mudra Reb. Corr., Nicor Gas. Ex. 29.0, 46:976-47:985; Nicor Gas Init. Br. at 89-90. Staff agrees with Nicor Gas' rejection of this proposal and recommends that Nicor Gas continue calculating the SWF on November 1. Staff Init. Br. at 121-22. In particular, Staff finds that "IIEC advanced no practical response that would enable the Company to calculate maximum values within months and between billing periods and meter reads." *Id*. at 121. The Commission should reject IIEC's request for a change in the calculation date of the SWF.

3. Costs Associated with Storage and System Losses

(a) Storage Loss Adjustment ("SLA") Factor

Having considered the Company's position, Staff no longer objects to the use of the Company's SLA factor in this proceeding. However, Staff recommends that the Commission "direct Nicor Gas to review its treatment of the allocation and recovery of the system and storage losses at the same time that it is reviewing the methodology for calculating the amount of storage losses and the procedures for accounting for these losses." Staff Init. Br. at 122. As noted in its Initial Brief, the Company agrees to the accounting procedures recommended by Staff with respect to storage gas losses and offers a plan for transitioning from the current approach to a revised approach, which will be implemented prospectively. Nicor Gas Init. Br. at 133-34.

As demonstrated by the Initial Briefs submitted by Staff and Intervenors, no party opposes Nicor Gas' SLA factor. As such, no party opposes including $15.2 million of storage losses in base rates in this proceeding.

(b) Unaccounted for Gas Adjustment ("UFGA")

Staff initially opposed the Company's allocation and recovery methodology. Specifically Staff objected "to the methodology which excludes Hub customers from any direct collection of the costs of either storage or system losses." Staff Init. Br. at 123. Staff now recommends that the Commission direct the Company on a prospective basis to review "the methodology for calculating the amount of storage losses and the procedures for accounting for these losses ... that Nicor Gas review with Staff and, if warranted, revise its treatment of the allocation and recovery of both storage and system losses through the UFGA." *Id*. Staff's recommendation should be rejected. Staff has failed to demonstrate a clear nexus between its UFGA concern regarding Hub activity and the prospective development of accounting procedures for the SLA factor above. Moreover, the Company fully explained how UFGA is already assessed to Hub volumes and how most Hub services are provided under tariffs approved by the Federal Energy Regulatory Commission and, therefore, beyond the authority of the Commission. Bartlett Sur., Nicor Gas Ex. 38.0, 16:357-18:401.

As demonstrated by the Initial Briefs submitted by Staff and Intervenors, no party opposes Nicor Gas' UFGA for purposes of this proceeding.

4. Intra-Day Nominations

CNE recommends that the Commission approve a modified version of Nicor Gas' alternative proposal to establish a modified evening nomination cycle, with a deadline of

3:00 p.m. the business day before the start of the gas day. CNE Init. Br. at 6-7, 35-38. CNE proposes that the modified evening nomination cycle should also allow corrections of any mismatched timely cycle nominations. *Id*. at 42. Staff continues to recommend that the Commission order a pilot program to provide evening nominations and intraday nominations on a "best-efforts" basis. Staff Init. Br. at 123-24.

In the interest of compromise, Nicor Gas offered in its surrebuttal testimony that it would be willing to pursue a pilot program with certain parameters if the Commission deems it necessary for Nicor Gas to offer some type of late or intraday service. Bartlett Sur., Nicor Gas Ex. 38.0, 43:966-78. CNE agrees to the Company's alternative proposal subject to certain modifications. CNE Init. Br. at 35-38.

Based upon post-hearing discussions, CNE and Nicor Gas agree to resolve this issue as follows: Nicor Gas agrees that it will implement its proposed alternative intraday nomination process as summarized in Nicor Gas Exhibit 38.0 (lines 962-78) in which it will add an additional late nomination cycle (a modified Evening cycle) with a deadline of 3:00 p.m. the business day before the start that would be capped according to Nicor Gas's capacity availability. In addition, Nicor Gas agrees that such modified Evening Cycle nomination: (1) is offered on a firm basis to the extent the volume is within the 1:00 p.m. posted availability for that date; (2) is available to all Nicor Gas Transportation customers; and, (3) includes, at a minimum, an additional 20,000 MMBtu on a daily basis over and above the volume of Timely cycle nominations. Further, Nicor Gas will enter into collaborative sessions with interested entities to work on the resolution of nomination errors that occur solely due to an incorrect pipeline designation (*i.e.*, there are no changes in the volume or scheduling of the nomination, but gas flow is actually on a different pipeline than the one designated upon submission of the nomination in the Timely cycle) and report back to the Commission.

Because CNE agrees to this alternative proposal subject to certain modifications, CNE Init. Br. at 35-38, and Nicor Gas agrees to those modifications, the Commission should approve this compromise position.

5. Trading of Stored Gas

Vanguard requests that the Commission adopt the recommendation agreed to by Nicor Gas and Vanguard and set forth in Nicor Gas' Initial Brief. Vanguard Init. Br. at 1. Specifically, after Nicor Gas proposed revised language for Rider 25 that addressed Vanguard's concerns about the ability of Transportation customers to move or "trade" gas stored in excess of their storage capacity for the purpose of avoiding recurring penalty conditions, Vanguard withdrew its proposal regarding storage balances trading for purposes of this proceeding. Nicor Gas Init. Br. at 93-94.

Staff argues that the agreement between Nicor Gas and Vanguard is not appropriate for two reasons: (1) the agreement purportedly unduly restricts the balance trading to one time per customer per year and is only available to smaller customers on Rider 25; and (2) Nicor Gas purportedly has not supported its request to increase the Excess Storage Balance Transfer fee from $15.00 to $24.00. Staff Init. Br. at 124-26. Staff also argues, without any evidence showing such a connection, that the proposal to allow balance trading "will help users achieve the 90% target on November 1 as it allows transportation customers with balances below 90% to purchase gas from those with balances above 90%." *Id*. at 121.

None of Staff's arguments warrant rejection of the negotiated agreement between Nicor Gas and Vanguard. *See* Nicor Gas Init. Br. at 93-94. Given that Vanguard operates in the market, the Commission should give weight to its agreement, as opposed to Staff's speculation.

Accordingly, the Commission should reject Staff's trading of storage balances proposal in light of the agreement reached by Nicor Gas and Vanguard on this issue.

6. Super-Pooling on Critical Days

CNE originally proposed that Nicor Gas permit super-pooling for third-party Suppliers in commonly-managed groups on Critical Days, which would require Nicor Gas to aggregate or net all the gas delivery and storage balance information across all the Supplier's individual groups. CNE Init. Br. at 38-39. Although Nicor Gas originally opposed this proposal for numerous reasons, Mudra Reb. Corr., Nicor Gas Ex. 29.0, 34:724-35:744, the Company devised a manual process that would accommodate the issue of a Rider 13 Supplier being faced with a penalty portion of the Unauthorized Use Charge on a Critical Day if the Supplier's Rider 13 groups had sufficient deliveries in aggregate. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 56:1213-57:1234.

CNE recommended that the Commission adopt Nicor Gas' compromise position as it applies to the $6 per therm penalty portion of the Unauthorized Use Charge, "provided that, in order to address the requirement that the customer purchase replacement gas even though the supplier has satisfied the aggregate needs of all of its pooled customers, Nicor [Gas] should be required to collaboratively work towards a solution to address Super Pooling for the purchased gas component of the Unauthorized Use Charge." CNE Init. Br. at 7, 40-41. Nicor Gas agrees to collaboratively work with CNE to address its concerns with respect to this latter point.

Inexplicably, Staff supports CNE's original proposal without even acknowledging the compromise proposed by Nicor Gas and recommends that the Commission order Nicor Gas to expand super-pooling to apply to penalties on critical days and the spring cycling target. Staff Init. Br. at 126-27.

Based upon post-hearing discussions between CNE and the Company, Nicor Gas will implement an alternative Super Pooling process as summarized in CNE' Init. Br. at 38-41. Nicor

Gas will enter into collaborative sessions with interested entities to work towards a solution to address Super Pooling for the purchased gas component of the Unauthorized Use Charge and report back to the Commission with the results. Therefore, the Commission should reject the concept of super-pooling for third-party Suppliers on Critical Days and accept the CNE / Nicor Gas agreement.

7. Seasonal Usage Maximum

Nicor Gas' position regarding the Seasonal Usage Maximum is addressed above in Subsection VIII.C.5 and is fully incorporated herein.

8. Settlement of Issues Between Nicor Gas and CNE

Nicor Gas and CNE have agreed to resolve several issues in this proceeding so as to minimize the time, expense, and uncertainty of protracted litigation. The resolutions are not binding on the parties unless and until they are approved by the Commission. The resolutions shall not constitute admissions of any kind with respect to any legal or factual issue in any of the proceedings, appeals or issues being addressed by these agreements or with respect to any other proceeding or dispute. Nicor Gas and CNE understand that the resolution of issues shall not be offered or entered into evidence in any proceeding before the Commission or any other administrative agency or in any court, except in connection with the proceedings related to the performance, implementation, or enforcement of their agreements. Further, it is the understanding of Nicor Gas and CNE that the resolutions between them as presented to the Commission for approval shall not have any precedential value in any future proceedings that address the rates or tariffs of Nicor Gas or any other utility.

X. TARIFF REVISIONS AFFECTING CUSTOMER SELECT CUSTOMERS

A. Overview

Nicor Gas incorporates herein the Overview discussion from Subsection X.A of its Initial Brief.

B. Uncontested Issues

Nicor Gas incorporates herein the discussion of the Uncontested Issues from Subsection X.B of its Initial Brief.

XI. EXISTING RIDERS

A. Rider 2 – Franchise Cost Adjustment

Nicor Gas incorporates herein the discussion of the Uncontested Issues from Subsection XI.A of its Initial Brief.

B. Rider 5 – Storage Service Cost Recovery

Nicor Gas incorporates herein the discussion of the Uncontested Issues from Subsection XI.B of its Initial Brief.

C. Rider 8 – Adjustments for Municipal and State Utility Taxes

Nicor Gas incorporates herein the discussion of the Uncontested Issues from Subsection XI.C of its Initial Brief.

XII. NEW RIDERS

A. Overview

Nicor Gas proposed five new riders that remain contested. Each rider will provide Nicor Gas the opportunity to recover costs or revenues approved in this case—no more, no less. The Commission should approve each new rider.

- Rider UEA and Rider CUA provide for the Company's timely recovery or refund of the volatile and significant cost associated with bad debt and gas used in the normal course of business operations, which results from the effects of year-to-year volatility in natural gas prices.

- Rider VBA and Rider EEP break the direct link between delivery volumes and the Company's recovery of fixed costs, which, in turn, will promote greater energy efficiency. The Commission approved substantially similar volume balancing adjustment and energy efficiency riders in the 2007 Peoples Rate Case.

- Rider QIP establishes a mechanism for recovering costs associated with the Company's ongoing replacement of its old cast iron main and copper services at a rate that would better keep pace with the declining performance of the materials.

Incredibly, Staff and AG/CUB claim that these riders are outside the Commission's authority and may not be approved, or are contrary to ratemaking principles and should not be approved, no matter how beneficial they are. Their arguments fly in the face of the Commission's recent affirmation of its rider authority in approving riders similar, if not substantively identical in at least one instance, to four of the five proposed riders. *See* 2007 Peoples Rate Case, Order at 138-53, 183-84; *Commonwealth Edison Company*, Docket No. 07-0566, Order at 103, 137-38 (Sep. 10, 2008) ("2007 ComEd Rate Case").

Moreover, the Company's proposed new riders are well within the parameters of the Commission's lawful authority, as has been recognized for 40 years under varying circumstances. *See, e.g., City of Chicago v. Ill. Commerce Comm'n*, 13 Ill. 2d 607, 611 (1958) ("*City I*") (recognizing that "it is clear that the statutory authority to approve rate schedules embraces more than the authority to approve rates fixed in terms of dollars and cents"); *A. Finkl v. Ill. Commerce Comm'n*, 250 Ill. App. 3d 317 (1st Dist. 1993) ("*Finkl*") (reversing order allowing rider recovery of a type of ordinary costs that should have been included in rate base); *City of Chicago v. Ill. Commerce Comm'n*, 264 Ill. App. 3d 403 (1st Dist. 1993) ("*City II*") (affirming order approving rider recovery of marginal cost of providing non-standard service); *Central Ill. Light Co. v. Ill. Commerce Comm'n*, 255 Ill. App. 3d 876 (3rd Dist. 1993) ("*CILCO*") (finding no abuse of discretion in the Commission's approval of coal tar remediation cost recovery through a rider mechanism); *Citizens Utility Board v. Ill. Commerce Comm'n*, 166

Ill. 2d 111, 140 (1995) (“*CUB*”) (determining that the “Commission’s approval of a rider as the preferred mechanism for recovery of coal-tar cleanup costs is within the Commission’s authority”); *City of Chicago v. Ill. Commerce Comm’n*, 281 Ill. App. 3d 617 (1st Dist. 1996) (“*City III*”) (affirming Order approving the use of a rider to recover local franchise fees).

The Commission recently analyzed this precedent in detail and reconfirmed its authority to approve rider mechanisms in cases such as this. In the 2007 Peoples Rate Case, the Commission was presented with several new “tracker” riders for approval, which are similar to some of Nicor Gas’ proposed new riders and were opposed by several parties on essentially the same grounds argued here. 2007 Peoples Rate Case, Order at 126-89. The Commission conducted a thorough review of its authority “from the very beginning… in the matter of riders.” *Id*. at 139. It found that the pertinent case law unquestionably demonstrates that the Commission has authority to approve rider mechanisms under the proper circumstances:

> [W]e observe, 37 years after it set out the seminal pronouncements in this field, the Illinois Supreme Court highlighted City I to affirm the Commission’s discretion in selecting the means by which rates are set and costs are recovered, and the appropriateness of the rider mechanism in certain instances. CUB v. ICC, 166 Ill. 2d 111 (1995). Thus, the whole of the case law settles the question of our authority to adopt the rider mechanism in proper situations and under circumstances that are lawful and reasonable.

Id. at 139-40.

Shortly after articulating its thorough analysis regarding riders in the 2007 Peoples Rate Case, the Commission relied upon that analysis in approving an infrastructure rider in the 2007 ComEd Rate Case:

> [I]t is clear that we have the authority to adopt the rider mechanism in proper situations and under circumstances that are lawful and reasonable. In fact, smart grid may be just the sort of investment that is appropriately recovered through a rider. … Rider SMP is

> approved … for the very limited purpose of implementing Phase 0—a scaled deployment of AMI—as a pilot program.

2007 ComEd Rate Case, Order at 137-38. The Commission also approved ComEd's new rider, Rider UF, which provided an alternative uncollectible expense mechanism. *Id*. at 103.

Further, the Commission in the 2007 Peoples Rate Case concluded, after analyzing the precedent, that a rider mechanism does not violate the regulatory doctrines of single-issue ratemaking, retroactive ratemaking and the Commission's test year rules. Specifically, the Commission found:

- Single-Issue Ratemaking: "From the whole of this authority, we believe it clearly established that the prohibition against single issue ratemaking is operable only in the context of a rate case, and during the phase that balances the utility's cost and allowed revenues under the R=C+Ir formula. It is not applicable to a rider that merely facilitates direct recovery of a particular cost without upsetting a utility's revenue requirement."

- Retroactive Ratemaking: "The sound and enduring analysis in City I makes clear that an automatic rate adjustment clause does nothing to change the fixed and prospective nature of rates approved by the Commission. … This simply means that where a rate schedule approved by the Commission contains a mathematical formula for making future changes in the rate schedule, it is not unlawful under the doctrine of retroactive ratemaking."

- Test Year Rules: "We observe that the Illinois Supreme Court ultimately settled the question in CUB v. ICC, when it directly addressed the argument that a rider violates the Commission's own test year rules. … In the end, the Court resolved that the test year rule seeks to avoid a problem that is simply 'not present' when expenses are recovered through a rider. "

2007 Peoples Rate Case, Order at 142, 145-46 (citations omitted).

The Commission's exhaustive analysis and affirmation of its authority to approve riders in the 2007 Peoples Rate Case, and echoed in the 2007 ComEd Rate Case, sends a clear message to AG/CUB, which continues to offer the same well-worn arguments here with respect to each of

Nicor Gas' proposed new riders.[13] AG Init. Br. at 25-94. Nicor Gas will not repeat that analysis in countering those arguments. Instead, Nicor Gas respectfully refers generally to the Commission's reasoned and thorough discussion of its rider authority.

AG/CUB's additional argument that Nicor Gas' rider proposals do not satisfy the mandate of the Act that rates be least-cost is unsupported and even illogical. AG Init. Br. at 33-34. Each rider will provide Nicor Gas the opportunity to recover costs or revenues that have been expressly approved by the Commission in this case. "Least cost" is an efficiency standard—customers should receive their services at the least cost—not a prohibition on alternative recovery mechanisms. Moreover, each of the Company's proposed riders include a reasonableness review of actual costs during annual reconciliation proceedings, so the Commission will have the opportunity to determine whether the costs sought to be recovered under the riders are reasonably incurred. *See* 220 ILCS 5/1-102(a)(iv).

AG/CUB also argues that there are narrow criteria that must be met before the Commission should approve a rider "as an extraordinary cost recovery mechanism." AG Init. Br. at 30-31. AG/CUB claims that the expenses sought to be recovered under a rider must be "unexpected, volatile or fluctuating," and largely outside the utility's control, citing *Finkl*. *Id*. AG/CUB variously asserts applicable "criteria" as being large, volatile, fluctuating, unexpected or beyond the control of the utility, even though some of these "criteria" are not mentioned in *Finkl*. AG Init. Br. at 30-31, 40, 45-46, 63-65, 90-91. Staff similarly makes claims about a purported "customary standard for volatility that justif[ies] implementation of a rider." Staff Init. Br. at 142.

[13] Although AG/CUB supports approval of Rider EEP, it raises these arguments in its opposition to the Conservation Stabilization Adjustment proposed as part of Rider EEP, in the event Rider VBA is not approved.

Both AG/CUB and Staff take liberties with the evidence in this case by arguing that Nicor Gas somehow agreed that "volatility" in costs is "necessary for rider recovery or that riders "should be used, if at all, only for significant expenses that are volatile and largely outside the utility's control." AG Init. Br. at 28; *see* Staff Init. Br. at 169. Both AG/CUB and Staff cite to the direct testimony of Nicor Gas witness O'Connor as allegedly providing support for these claims. The pertinent portion of Mr. O'Connor's testimony, in full, is as follows:

> Riders traditionally have been used to provide utilities with a reasonable opportunity to recover specific costs that do not easily fit into the test-year approach to ratemaking. *One reason* these costs do not fit into the test-year approach is that they are volatile, significant and are largely out of the control of the utility. Riders are designed such that specific costs are recovered in a timely manner, and customers only are charged for the reasonable and prudent costs actually incurred.

O'Connor Dir., Nicor Gas Ex. 12.0, 5:90-6:95 (emphasis provided). Contrary to the misstatements of AG/CUB and Staff, Nicor Gas has never agreed that there are certain criteria that must be met before the Commission may approve a rider.

Further, AG/CUB's construction of *Finkl* as setting forth an exclusive list of criteria for approval of riders is flatly wrong. Indeed, the same Illinois court that decided *Finkl* later confirmed that use of a rider is not limited "only to those cases where expenses are unexpected, volatile, or fluctuating" (*City III*, 281 Ill. App. 3d 617 at 628) and specifically rejected arguments that its earlier decision in *Finkl* so limited the use of riders. *Id*. Moreover, the Commission confirmed in the 2007 Peoples Rate Case that the *Finkl* standards are not exclusive "all-or-nothing factors." 2007 Peoples Rate Case, Order at 186. AG/CUB's construction of *Finkl* is puzzling in light of the Illinois Appellate Court's clear pronouncement in *City III* and the Commission's analysis of the decision in the 2007 Peoples Rate Case:

> Notably, in [City III], the court considered the City's reliance on Finkl for the very proposition that only unexpected, volatile or fluctuating expenses are properly recovered through a rider. This opinion (and, notably, by the very same appellate district that decided Finkl) makes clear that:
>
>> A Finkl, however, should not be so narrowly construed. In A. Finkl, we stated that "riders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses." (Emphasis omitted.) A. Finkl, 250 Ill. App. 3d at 327, 620 N.E.2d at 1148. Nothing in the language of A. Finkl, or the case upon which we relied, Citizens Utility Board, 13 Ill. 2d at 614, 150 N.E.2d at 780, limits the use of a rider only to those cases where expenses are unexpected, volatile, or fluctuating. Id. at 628.
>
> Thus, the City III court construed the opinion of the Illinois Supreme Court to mean that *there is no requirement and no limitation on the Commission to use a rider mechanism only for costs that are unexpected, volatile or fluctuating*. This brings us back to the pronouncements that riders are allowable in the proper case, and under circumstances that reflect the need for pragmatic adjustments.

2007 Peoples Rate Case, Order at 149-50 (emphasis provided).

In light of the Orders in the 2007 Peoples Rate Case and the 2007 ComEd Rate Case, where the Commission approved new riders involving various categories of recovery, there can be no doubt of the Commission's rider authority and the wide discretion the Commission enjoys in approving rider recovery. The categories of rider recovery approved by the Commission in these Orders—revenue decoupling, energy efficiency program costs, infrastructure investment, and uncollectibles—arose from the implementation of programs that addressed each utility's business needs and demonstrate the Commission's latitude in identifying "circumstances that reflect the need for pragmatic adjustments." 2007 Peoples Rate Case, Order at 150; *see also City I*, 13 Ill. 2d at 618; 2007 Peoples Rate Case, Order at 150-53, 183-84. Four of Nicor Gas' five proposed new riders are similar to riders already approved by the Commission, and recover unique types of costs in a manner that justifies the Commission's approving pragmatic rate adjustments in the form of riders.

In sum, all of Nicor Gas' proposed new riders satisfy the legal standards for rider recovery most recently recognized by the Commission's Orders in the 2007 Peoples Rate Case and the 2007 ComEd Rate Case. Moreover, as discussed in further detail below, the rider proposals are appropriate and necessary cost recovery mechanisms. Accordingly, Nicor Gas' proposed new riders should be approved by the Commission.

B. Rider 26 – Uncollectible Expense Adjustment

1. Arguments that the Company Should Bear All Risks Associated with Increasing Uncollectible Expense are Shortsighted and Contrary to Sound Regulatory Policy

Staff takes issue with what it characterizes as the Company's "one-sided nature" of Rider UEA proposal, stating that "[a]s the financial risks increase within the Company's service territory, the Company seeks a solution that protects Nicor Gas by shifting further risk to ratepayers," in support of the rider proposal. Staff Init. Br. at 139. The AG and CUB echo Staff's sentiment in their Initial Briefs. AG Init. Br. at 38; CUB Init. Br. at 32. First, what should be clear from the evidence presented in this case is that the level of uncollectible expense is related to a factor largely beyond the Company's control—namely gas costs. O'Connor Dir., Nicor Gas Ex. 12.0, 11:181-12:185. To address the uncontrollable factor, the Company has proposed a mechanism that treats both ratepayers and the Company symmetrically. Further, Staff's argument regarding the "fairness" of the alleged shifting of risk to ratepayers ignores the simple truth that uncollectibles, in the end, are an expense generated by ratepayers themselves when failing to pay accounts due. To be clear, the Company is *not* arguing that Rider UEA should be implemented as some sort of fault-based proposal that seeks to punish ratepayers. Rather, Rider UEA should be implemented to address costs that are outside of the Company's control. It is clear that factors creating the current uncollectibles environment are beyond ratepayers control as well as beyond the control of the Company.

2. Volatility in the Price of Gas, Combined with Other Economic Factors, Creates Uncollectible Expense Largely Beyond the Company's Control

Those opposing Rider UEA assert that uncollectible expenses are not volatile in comparison to other system costs and, therefore, do not warrant rider recovery. Staff Init. Br. at 139-42. As the Company has demonstrated, the rate of change to Nicor Gas' Uncollectible Expense is closely correlated to the change in natural gas prices, which, as recognized by Staff witness Brightwell, are "very volatile." O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 10:203-11:205; Brightwell Dir., Staff Ex. 13.0, 22:437; *see also* Kirby Dir. Corr., Nicor Gas Ex. 6.0, 15:318-19:409; Kirby Reb., Nicor Gas Ex. 21.0, 3:64-7:155; Kirby Sur., Nicor Gas Ex. 40.0, 2:40-4:84. As discussed above, case law interpreting the use of riders in Illinois does not demand a rigid adherence to tests for "volatility" or questions of whether uncollectible expense is beyond the Company's control. *See, e.g.*, *City III*, 281 Ill. App. 3d 617 (1st Dist. 1996). However, such questions are useful in demonstrating why expenses such as uncollectible expense are uniquely suited for recovery via a rider mechanism.

Staff's assertion that "the Company has not increased its efforts to address uncollectibles despite these bad debt trends" is completely contrary to the facts presented in this case. Staff Init. Br. at 143. In data request responses and in rebuttal testimony, the Company has provided evidence of its extensive collection efforts. Kirby Dir. Corr., Nicor Gas Ex. 6.0, 18:383-19:409; Kirby Reb., Nicor Gas Ex. 21.0, 17:360-22:478; Nicor Gas Ex. 21.4, 21.5. This evidence was unrebutted in Staff and Intervenor testimony. Similarly, the Company explained that the number of its customers that have been disconnected for non-payment is an unreliable and misleading measure of its collection efforts, an explanation that Staff also ignores in its Initial Brief. Staff

Init. Br. at 143. In summary, the Company has never argued that Uncollectible Expense is completely out of its control, and it need not so argue under Illinois law. The Company has demonstrated that it is making all reasonable and prudent efforts at reducing bad debt, and that despite these efforts, uncollectible expense continues to increase. Kirby Dir. Corr., Nicor Gas Ex. 6.0, 18:383-19:409; Kirby Reb., Nicor Gas Ex. 21.0, 17:360-22:478; Nicor Gas Ex. 21.4, 21.5.

3. Rider UEA Provides Appropriate Incentives

In its Initial Brief, Staff has narrowed its focus regarding the perceived disincentive created by Rider UEA's +5% deadband mechanism. Staff states: "the issue for Staff is the lack of incentives outside the ±5% deadband," arguing that the Company will lack incentive to disconnect for non-payment. Staff Init. Br. at 143-146, *see also* AG Init. Br. at 39. However, this argument does not comport with the reality of the collections process as described by the Company in unrebutted testimony before this Commission. Kirby Dir. Corr., Nicor Gas Ex. 6.0, 18:383-19:409; Kirby Reb., Nicor Gas Ex. 21.0, 17:360-22:478; Nicor Gas Ex. 21.5, 21.5. Disconnection is a final step in a long process, and is in large part governed by the dictates of Part 280. The Company's efforts at recovering past due amounts are not dependent upon whether those past due amounts are on accounts that will ultimately end in disconnection. Kirby Dir. Corr., Nicor Gas Ex. 6.0, 18:383-19:409; Kirby Reb., Nicor Gas Ex. 21.0, 17:360-22:478; Nicor Gas Ex. 21.5, 21.5. Any suggestion that Nicor Gas would be less incented to effectively manage its Uncollectible Expense process fundamentally misunderstands the business operations of the Company. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 13:252-57. Nicor Gas is incented to expedite cash collections, and reduce the number of days between delivery of gas service and receipt of cash. *Id.*, 13:258-60. This incentive exists for all past due amounts, whether or not non-payment will lead to disconnection. The dead-band itself provides a significant incentive to the Company to either avoid higher Uncollectible Expense or attain the benefit of a lower Uncollectible Expense, an incentive which effectively negates the hypothetical incentive of encouraging non-paying customers to remain connected, as envisioned by Staff and the AG. *Id*., 13:262-65. Accordingly, the Company's proposed Rider UEA should be approved.

C. Rider 27 – Company Use Adjustment

Staff identified three concerns with Rider CUA: (1) whether gas lost and unaccounted for gas storage losses are being measured properly and whether accounting consequences make rider recovery inappropriate; (2) whether Company use gas costs reach a level to warrant rider recovery; and (3) whether the rider adversely affects the Company's incentive to seek new ways to reduce natural gas usage and reduce the Company's exposure to price volatility. Staff Init. Br. at 147.

The AG and CUB arguments against Rider CUA include that the Commission has already ordered Nicor Gas to treat the largest component of Rider CUA (gas losses) as a base rate item; and that the remaining costs to be included in the rider (gas that Nicor Gas uses for compressor stations and office buildings) do not fluctuate significantly are inappropriate for rider recovery. AG Init. Br. at 46-48.

These arguments do not diverge significantly from those presented in testimony. Nicor Gas has shown why these arguments are without merit. *See* O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 14:282-17:355; O'Connor Sur., Nicor Gas Ex. 46.0, 9:190-13:266. Further, Company use gas is directly impacted by the price of natural gas, and while the Commission had previously removed its recovery from Rider 6, there was no express prohibition from seeking rider recovery in future proceedings. *See generally* 2004 Rate Case, Order. Moreover, the Company has set forth sufficient rationale to permit recovery of this cost through a rider. Company Use expense is a significant cost to Nicor Gas and is driven by natural gas prices, which are volatile and not within the control of the Company. O'Connor Sur., Nicor Gas Ex. 46.0, 12:252-54. No opponent of Rider CUA has claimed, in Initial Brief, that gas prices are not volatile. *Cf.* Brightwell Dir., Staff Ex. 13.0, 22:437. Rider CUA provides Nicor Gas a reasonable opportunity to recover its actual Company Use costs and, because it only applies to changes in gas prices at test year volumes and not to changes in volumes of Company Use gas consumed, also creates a strong incentive for Nicor Gas to do all it can to manage those volumes effectively. *Id*., 12:258-13:261. Finally, Rider CUA benefits the Company's customers by providing a reduction in their bills if gas prices fall below the gas price used to calculate the amount of Company Use expense included in base rates. *Id*., 13:261-63. Because Rider CUA is designed to be fair and equitable both to Nicor Gas and its customers, the Commission should approve the Company's Rider CUA.

D. Rider 28 – Volume Balancing Adjustment

Staff outlines its proposed alternative form of Rider VBA for the Commission's consideration should it decide to approve a Rider VBA pilot program. Staff Init. Br. at 152-154. Staff's alternative is not tied to rate case margin per customer; instead, it looks only at total distribution revenues to cover fixed costs as approved in a rate proceeding. Mudra Sur. Corr., Nicor Gas Ex. 48.0, 64:1404-66:1443. The Company opposes Staff's alternative because it fails to address the costs the Company incurs when adding new customers to the system, costs that are not reflected in test year costs considered in this proceeding. *See* O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 19:399-20:401.

The AG and CUB, in their Initial Briefs, oppose the use of a volume balancing rider, despite recent Commission approval of a volume balancing rider. AG Init. Br. at 53-77. AG/CUB witness Rubin claims that the Company would no longer be required or incented to serve its customers fails, because Nicor Gas has an unqualified statutory obligation to serve its customers. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 21:433-42; 220 ILCS 5/8-101. Additionally, Nicor Gas presented evidence showing that, under its current rate design, the Company does not recover its prudently incurred costs, and has not earned, nor is forecasted to earn, the rate of return allowed in the 2004 Rate Case. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 22:448-53; Hawley Dir., Nicor Gas Ex. 1.0, 6:108-26. Therefore, AG/CUB's opposition to Rider VBA should be reject. The Company's Rider VBA should be approved.

E. Rider 29 – Energy Efficiency Plan

Staff recommends rejection of Rider EEP. Staff Init. Br. at 155-56. Staff stands alone in this proceeding when recommending the rejection of the rider, which is designed to enable the operation of an energy efficiency program within Nicor Gas service territory. However, if Rider EEP is approved, Staff recommends several changes, including that the Commission remove the Conservation Stabilization Adjustment ("CSA") clause from the rider; that the management structure be altered to ensure that Nicor Gas has "clear responsibility for any expenditure made in the promotion of energy efficiency," and that the program proceed as a pilot program, at reduced cost. Staff Init. Br. at 157. The AG also supports the elimination of the CSA from Rider EEP. AG Init. Br. at 43-53, 76.

1. The Conservation Stabilization Adjustment is Vital to Promote the Success of the Program if Rider VBA is Not Approved

The CSA recovery mechanism allows the Company to recover revenues that are lost due to therm reductions resulting from those energy efficiency programs approved and implemented by the Advisory Board. Nicor Gas Init. Br. at 118, *citing* Nichols Sur., Nicor Gas Ex. 47.0, 4:78-80. The Advisory Board would approve the programs and determine the therm reduction attributable to the program's impact on both residential and non-residential usage. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 24:498-501. Nicor Gas would multiply those therm levels by the last distribution block charge for the respective rate class to determine the amount of lost revenue. *Id*., 24:501-02. The lost revenue would be included as a cost in the annual Rider EEP charge and be recovered from customers. *Id*., 24:502-04.

Staff states the following concerns with the CSA: (1) the difficulty of estimating savings for some projects, and (2) "the ex-ante estimation of free riders." Staff Init. Br. at 162.

Staff's concern with the difficulty of assigning savings to particular programs and the possible incentive to overestimate the impact of these savings is misplaced in this context. While it is true that each individual program is to be assigned a savings amount generated from that program's therm reduction, it does not follow that individual program therm reductions, even if overstated, will result in an overstatement of the Company's lost revenue. As explained in testimony, the therm reduction calculations are to be tested annually by looking to two calculations: the system-wide comparison of actual-versus-forecasted throughput, and the per program savings approved by the Advisory Board. Nichols Sur., Nicor Gas Ex. 47.0, 5:107-6:117. Further, when the sum of all per-program savings are greater than any amount of decline that goes beyond forecasted demand decline, the program mandates that therm reductions/savings attributed to each individual program would have to be corrected. *Id*. The reduction in demand or throughput, beyond the forecasted reduction, constitutes the universe of annual savings that may be attributed to the EEP. *Id*. This same reduction in demand over forecasted demand represents the maximum amount that can determined to be the Company's lost margin as a result of EEP. *Id*.

Therefore, the total number of therms saved from all programs is the number used to calculate the CSA. The Rider EEP tariff itself refers to this as the "sum of the deemed total annual therm reductions." Mudra Reb. Corr., Nicor Gas Ex. 29.1 at 27 of 32. The total therm reduction attributable to all programs should not be affected because of difficulties in measuring therm reduction attributable to one program, such as the "market transformation" programs used as an example by Staff. Staff Init. Br. at 162. Additionally, the structure of the Advisory Board itself acts as a check on therm reduction assignations. Nichols Sur., Nicor Gas Ex. 47.0, 4:85-88. Staff's concerns are therefore misplaced.

The "free rider" problem as articulated by Staff witness Brightwell and included in Staff's Initial Brief addresses situations where a customer "used program funds for a project that would have been completed regardless of the program's existence." Staff Init. Br. at 162. Essentially, Staff argues that the Energy Efficiency Program, in these cases, will get credit for therm reduction that it does not deserve (since it would have happened anyway). *Id*. For example, a "free rider" is someone who would have purchased an energy efficient appliance without any economic incentive from the Program, but still takes program funds to complete the purchase. Tr. at 578-80. While the Company does not doubt that EEP may encounter some "free riders" as defined by Staff, there has been no evidence presented to establish that such instances will result in any discernable affect on therm reduction attributed to the success of the Program. Moreover, there is nothing within the Company's Rider EEP proposal that would prevent the Advisory Board from considering the impact of free rider and adjust goals accordingly. O'Connor Reb. Corr., Nicor Gas Ex. 27.0, 25:525-26:539.

Nicor Gas has proposed Rider EEP with the CSA as an essential prerequisite in the absence of Rider VBA. There has been no evidence to suggest that CSA provides anything more than redress for lost revenues that the Company would not have lost but for the implementation of Rider EEP. If Rider VBA is rejected by the Commission, the Company's proposed Conservation Stabilization Adjustment should be included as a critical element of Rider EEP.

2. The Constitution of the Advisory Board, as Proposed, Presents the Best Option for Program Success

Staff, in its Initial Brief, presents the issue of the proper composition of the advisory board as a "conundrum." Staff Init. Br. at 164. Staff argues that although the Advisory Board is set up to be largely autonomous, with only one Nicor Gas representative on the Advisory Board, Nicor Gas' influence is pervasive because Nicor Gas may choose to discontinue the program at the end of the four year pilot. *Id* Staff worries that if Nicor Gas is absolved from accountability for imprudent expenditures, despite this argued influence, then there is limited accountability for the program. *Id*. However, Staff also acknowledges that if Nicor Gas is held strictly accountable for the actions of the board and the prudence of expenditures, the "continued existence of the program is compromised." *Id*.

Staff's recognition that requiring Nicor Gas to bear ultimate responsibility would jeopardize the program's existence is really the crux of the "conundrum" presented here. Energy conservation and efficiency are both laudable and essential goals; however, the very success of those goals leads to a direct and negative impact on the Company's ability to recover its revenue requirement. This creates an inescapable conflict of interest. The proposed Energy Efficiency Program is designed to put the decisions of what portfolio of programs would best serve Nicor Gas' customers and service territory under the control of a qualified, experienced and independent board. Nicor Gas Init. Br. at 115-16, *citing* Nichols Reb. Nicor Gas Ex. 28.0, 2:49-3:53. This is essential for the program's success. Nicor Gas will act primarily as fiscal agent, and because the Company is ceding control of the program to the Advisory Board, it would be unfair to hold it accountable for the prudence of decisions made by those with far more experience with energy conservation and efficiency. Staff's suggested solution for addressing the conundrum is really no solution at all: Staff suggests a "board that is empowered to act in an advisory capacity only." Staff Init. Br. at 164. Clearly, this proposed solution does nothing to eliminate concerns, recognized by Staff, regarding the viability of the program if outside experts are not given control of program decisions and funding.

Further, Staff is incorrect in asserting that "there is effectively no method for the ratepayers to be protected from imprudent expenditure, and limited accountability in the program." Staff Init. Br. at 164. Both AG/CUB and Staff agree that the Advisory Board, as structured in the Company's proposal, is accountable to the Commission. AG Init. Br. at 73; ELPC Init. Br. at 4-6. As ELPC notes in its Initial Brief:

> . . . the Advisory Board structure will ultimate[ly] provide greater benefits to consumers than a utility run program. While the Commission cannot directly hold the Advisory Board financially responsible by disallowing the recovery of costs for the programs, this is more than outweighed by the fact that the Advisory Board will not have the conflict of balancing the needs of shareholders with those of customers. Nicor has been in the business of selling gas -- not helping customers reduce consumption. The financial structure of the company, and the traditional ratemaking framework, rewards the company for selling more gas -- not saving it. . . . ELPC also notes that the Commission does in fact maintain significant authority over the program. The Commission has broad powers to regulate utilities and oversee programs such as this one.

ELPC Init. Br. at 6.

Like Staff, the AG states the Company could be held financially responsible for the actions of the Advisory Board by ordering "the refund of funds spent on those programs." AG Init. Br. at 74, *citing* Nichols Sur., Nicor Gas Ex. 47.0, p. 9. The Company agrees that the Commission could order refunds of unused program funds or terminate programs. Nichols Sur., Nicor Ex. 47.0, 9:180-84. It disagrees however, with the AG's statement that it attributes to Nicor witness Nichols. AG Init. Br. at 74. Nicor Gas never stated the Commission should order refunds of previously spent funds as set forth in the AG's Initial Brief. AG Init. Br. at 74, *citing*

Nichols Sur., Nicor Ex. 47.0, p. 9. The problem of holding the Company financially accountable for the actions of the independent Advisory Board was highlighted in the cross examination ELPC witness Kupert. When asked whether the Company should be held financially responsible for imprudent expenditures such as a boondoggle trip to Argentina by the Advisory Board, Mr. Kupert responded "Yes." Tr. at 157:10-159:10. This example, while perhaps silly, evidences the unreasonableness of holding the Company financially accountable for imprudent expenditure made by an independent Advisory Board.

The Company's proposal calls for an independent audit after 24 months, and Staff witness Brightwell has acknowledged that it is within the Commission's authority to act to redress any problems with the program as it sees fit, upon its own motion. Tr. at 582-84. The Commission's authority, ongoing audits, together with the independent structure of the Advisory Board, make it unnecessary to impose upon the Company financially responsibility for actions later deemed imprudent.

3. The Company's Proposed Budget is Reasonable and Should be Adopted

Nicor Gas has proposed a $13 million program budget cap, admittedly because of the Commission determination in the Peoples Gas Order and the funding level sought by Ameren in its rate cases. Nichols Dir., Nicor Gas Ex. 13.0, 3:55-68. The portion of the $13 million that is allocated to the residential class is $9.3 million, or about $0.40 per customer per month. *Id*. In their respective Initial Briefs, Staff has proposed reducing the amount of funding for the program, while ELPC has proposed a significant increase. Staff Init. Br. at 157; ELPC Init. Br. at 6-7. Nicor Gas maintains that the $13,000,000 cap is an appropriate number for the four-year pilot program, resulting in a cost per customer that is comparable to that of Peoples' Gas. *Id.*; *see* Nicor Gas Init. Br. at 116-17.

F. Rider 30 – Qualifying Infrastructure Plant

Staff and the AG reiterate their objections to Rider QIP in their Initial Briefs (CUB adopts the AG's arguments regarding all New Riders). To the extent that these arguments are a retread of issues presented by Staff and the AG in testimony and in turn rebutted by Nicor Gas, the Company adopts and incorporates its responses as if fully set forth within this Reply. However, in some instances, with regard to Rider QIP, the issues presented in the Initial Brief demand a direct response to both clarify and correct the characterizations of the Company's position in this proceeding.

1. Whether Cast Iron and Copper Services Replacement, as Contemplated by Rider QIP, is Critical to Maintaining a Safe and Reliable System is Not the Appropriate Standard to Apply in Evaluating the Rider Proposal

Staff, in its Initial Brief, repeatedly states that the Company has not shown that Rider QIP is required to maintain a safe and reliable gas distribution system. Staff Init. Br. at 166, 168-72. Staff cites the following statement from the Commission's 2007 Peoples Rate Case Order:

> In the case of Rider ICR, the Utilities' proposal is insufficient for the Commission to approve it. It might have been easier to approve the rider had the Utilities included, or the Staff or the Intervenors' [sic] elicited, such information as: a detailed description and cost analysis of the proposed system modernization, and identification and evaluation of the range of technology options considered and analysis and justification of the proposed technology approach; a detailed identification and description of the functionalities of the new system, related both to system operation as well as on the customer side of the meter, as well as an identification and justification of functionalities forgone; analysis of the benefits of the system modernization, both to the system operation as well as to customers; these benefits should include reductions in system costs as well as an analysis of the range and benefits of potential new products and services for customers made possible by the system modernization; and analysis or regulatory mechanisms to allow companies to both recover their costs of system modernization as well as to flow reduced system costs back to customers; and an identification and

> analysis of legal or regulatory barriers to the implementation of system modernization proposals.

2007 Peoples Rate Case, Order at 162. Staff appears to agree that the Commission has articulated sound criteria for use in evaluating whether the use of a rider is an appropriate means for recovering costs attendant to the Company's accelerated cast iron main and copper services. Staff argues, however, that "[t]he Company failed to show that its proposed infrastructure replacement program meets the objectives articulated by the Commission [in the cited passage]." Staff Init. Br. at 171. Yet, Staff elaborates on the Company's "failed showing" by stating: "[p]articularly, Nicor Gas failed to demonstrate that the acceleration of the replacement of cast iron mains and copper services would have any impact on its ability to provide safe and reliable service to its customers." *Id*. Staff fails to explain why it chooses to read the "safe and reliable" requirement into the plain language of the Commission's Order, or why such a showing is of "particular" importance despite its absence from the Commission's Order.

The AG (and CUB) propose a similar standard in its Initial Brief:

> There simply is no basis in economics, safety, or reliability to conclude that Nicor's remaining cast iron main and copper services must be replaced during the next 10 years – requiring an annual level of replacement significantly faster than Nicor traditionally has done. Such a radical and expensive program should be undertaken only if it can be demonstrated that it is cost-effective and needed to ensure the provision of safe and reliable service to the public. Nicor has not made any such demonstration in this case.

AG Init. Br. at 88. While the AG's Initial Brief does not attribute this standard to the Commission (or to any authority), its argument also seeks to impose a test where the required "demonstration" is that safety and reliability are at risk.

It is important to clarify Staff and AG/CUB's misstatement of the appropriate standard for two reasons. First, to impose a standard whereby no extraordinary infrastructure improvements could be subject to rider treatment—absent proving that without said improvements, the safety and reliability of the system is jeopardized—would amount to an impossible standard, ensuring that no Illinois utilities could avail themselves of rider treatment for extraordinary infrastructure costs. This is contrary to both sound public policy and to the law in Illinois, which recognizes that riders, in appropriate circumstances, present a valuable and useful tool for Commission use under "circumstances that reflect the need for pragmatic adjustments." 2007 Peoples Rate Case, Order at 150; *see also City I*, 13 Ill. 2d at 618; 2007 Peoples Rate Case, Order at 150-53, 183-84.

Second, Nicor Gas has never argued nor suggested, within testimony or otherwise, that Rider QIP is essential for it to be able to continue to provide safe and reliable service. To the contrary, the Company agrees with Staff and AG/CUB that its efforts to date in reducing leak rates from cast iron main and copper services have been successful in maintaining a safe and reliable system. McCain Reb. Corr., Nicor Gas Ex. 20.0, 7:154-8:169; McCain Sur., Nicor Gas Ex. 39.0, 4:84-91. The Company has stated:

> Absent the approval of this rider, the Company is committed to continuing to operate a safe and reliable system, utilizing the current analytical process we have adopted for managing our infrastructure. Our current process has allowed us to maintain a safe and reliable system, and has led to improved performance and a reduction in leak rates. However, while our current process has proven to be adequate, it is not optimal. Rider QIP presents an opportunity for Nicor Gas to eliminate the threat to its system posed by a finite and easily-measured group of materials over a reasonable and clearly limited time period.

McCain Sur., Nicor Gas Ex. 39.0, 4:84-91. Clearly, Nicor Gas is committed to maintaining a safe and reliable system. Further, Nicor Gas agrees that a proper evaluation of the benefits of Rider QIP will necessarily include an evaluation of whether Rider QIP will serve the end result of maintaining a safe and reliable system. *See* McCain Reb. Corr., Nicor Gas Ex. 20.0, 2:43-

3:58. However, Staff and AG/CUB's suggestion that Nicor Gas' proposed rider must be denied absent a showing akin to immediate harm is shortsighted, illogical, and should be rejected.

2. Nicor Gas has Demonstrated and Quantified the Benefits that Rider QIP Will Bring to Both its System and its Ratepayers

Notably absent from Staff's Initial Brief is a recitation of the criteria which Staff argued should be used to evaluate the Company's Rider QIP proposal. Staff, in both rounds of testimony, stated that the Company must "provide an overall quantification of the program's affect on safety, reliability, efficiency, customer satisfaction, reduced operation and maintenance costs, balanced work load, and lower overall capital costs." Anderson Dir., Staff Ex. 9.0, 8:139-45; Anderson Reb., Staff Ex. 2.0, 4:66-6:119; *see also* Lazare Dir., Staff Ex. 7.0, 20:415-21:448. In testimony, Nicor Gas agreed that the factors identified by Staff were appropriate to use when considering the benefits of the infrastructure replacement program, and that indeed, Nicor Gas had clearly established that Rider QIP would provide each of the enumerated benefits and had appropriately quantified Rider QIP benefits. McCain Reb. Corr., Nicor Gas Ex. 20.0, 5:95-105. The Company again outlined the benefits and quantified savings in its Initial Brief. Nicor Gas Init. Br. at 123-25.

The Company maintains that the evaluation criteria recommended by Staff in testimony is an appropriate tool for Commission analysis of whether the accelerated replacement of cast iron main and copper services is a circumstance which warrants treatment. *See* McCain Sur., Nicor Gas Ex. 39.0, 2:32-4:91. An examination of the benefits to system performance and to ratepayers is a good place to begin an analysis of whether rider recovery is warranted. The Commission's Order in the 2007 Peoples Rate Case contains a similar contemplation of what factual circumstances would support rider recovery for an infrastructure replacement program. 2007 Peoples Rate Case, Order at 162. The 2007 Peoples Rate Case Order mirrored the language as Staff's proposed benefits evaluation in that case insofar as it called for an "analysis of the benefits of the system modernization, both to the system operation as well as to customers." *Id*. Notably, however, the Order did not call for a step-by-step quantification or assignation of a dollar value to each benefit identified, nor did it demand that "rigorous studies" be undertaken as a precursor to rider treatment.

Nicor Gas has provided more than sufficient analysis and evidence of the benefits of an accelerated replacement program. The Company has identified cast iron main and copper services as the greatest threat to its system. McCain Sur., Nicor Gas Ex. 39.0, 3:57-63. The leak rate per mile for cast iron main is 11.21 times higher, or 1020% higher, then for other materials in the Company's system. *Id*. at 4:70-83; McCain Sur., Nicor Gas Ex. 39.1. The leak rate for copper services is 4.77 times higher, or 377% higher, than for the rest of the services in the system. McCain Sur., Nicor Gas Ex. 39.0, 4:70-83; Nicor Gas Ex. 39.1. Rider QIP would allow the Company to replace these materials within ten years instead of a projected 32 years without the benefit of the rider. *See* O'Connor Dir., Nicor Gas Ex. 12.0, 29:549-51.

3. Rider QIP Allows for the Recovery of Discrete and Finite Costs Associated With the Replacement of a Limited Amount of Materials

Nicor Gas already has responded to Staff's and AG/CUB's arguments that the costs of an accelerated replacement program are prohibitive and disproportionate to the savings generated by the replacement, and it will not repeat those arguments here. However, by Staff's alternative argument that "[g]iven the relatively small amount of dollars at stake each year, the question arises whether the establishment of an oversight process for Rider QIP can be cost-justified" merits a clarification. Staff Init. Br. at 172. Staff's alternative position reflects its misunderstanding of the Commission's rules and the facts in this proceeding. The AG's position also suffers from a misunderstanding of the facts.

First, Rider QIP is specifically designed to limit the amount of annual expenditures. O'Connor Dir., Nicor Gas Ex. 12.0, 31:582-32:633. Its limitation is consistent with Part 656.30(a) of the Commission's Rules. 83 Ill Adm. Code 656.30(a). There, the Rules cap the amount of expenditures that can be made in furtherance of infrastructure improvement. *Id.* To argue the annual expenditures of Rider QIP are not significant enough to warrant rider recovery, as Staff does, is disingenuous in light of guidance provided by Part 656.30(a).

Second, Staff's calculation that "a maximum annual cost of $3.41 million that will be passed along to ratepayers" is incorrect. Staff Init. Br. at 172. Staff bases its calculation upon the Company's representation that a maximum cap of $20 million for the replacement of mains and services under Rider QIP and upon Nicor Gas' response to Staff Data Request DLH 10.05. *Id.*, *citing* Nicor Gas Resp. to DLH 10.05, Ex. 1. However, the Company did not state, in its response to DLH 10.05 or anywhere else, that the annual maximum expenditure would reach $20,000,000. The per year expenditure will be dependent upon many factors, the same factors which drive the prioritization of the removal of cast iron main and copper services under the current prioritization model, as described by Nicor Gas witness McCain. Tr. at 293:296:6.

Lastly, the AG argues that Rider QIP "will add some $20 million to annual customer rates." AG Init. Br. at 88. As stated, $20 million is the proposed maximum annual expenditure permitted under Rider QIP, however, the amount recoverable through Rider QIP would be limited to the recovery on and the depreciation expense related to the investment, not the total annual expenditure itself.

Rider QIP should be approved because it is appropriately designed to recover discrete and finite costs associated with the replacement of a limited amount of materials.

XIII. TERMS AND CONDITIONS

A. Proposed Changes

Nicor Gas incorporates herein the discussion of the Proposed Changes from Subsection XIII.A of its Initial Brief.

B. Uncontested Issues

Nicor Gas incorporates herein the discussion of the Uncontested Issues from Subsection XIII.B.1-12 of its Initial Brief.

C. Contested Issues

1. Non-Sufficient Funds ("NSF")

The Company proposes to increase the NSF charge from $16.00 to $25.00. Mudra Dir. Corr., Nicor Gas Ex. 14.0, 52:1145-46. Staff recommends approval of the Company's proposed NSF charge. Boggs Reb., Staff Ex. 21.0, 6:109-16.

AG/CUB argue the Nicor Gas fee should be limited only to the costs the Company incurs. CUB Init. Br. at 32; AG Init. Br. at 96. Both the AG and CUB argue that a NSF fee should not include any deterrent level. CUB Init. Br. at 33-34; AG Init. Br. at 96. Lastly, while CUB reiterates AG/CUB witness Rubin's double recovery argument the AG appears to have abandoned the argument given its absence from its Initial Brief. CUB Init. Br. at 33.

Nicor Gas incorporates herein the discussion of this issue from Subsection XIII.C.1 of its Initial Brief. Moreover, a utility's NSF fee need not be based solely on the utility's cost, as the Commission has determined on more than one occasion. While the Company proposes a $25 NSF fee like the fee approved for other utilities, it does not claim that simply because other utilities have a particular fee, Nicor Gas should be entitled to the same fee. Rather, the Company compares its proposed fee to that of Peoples, North Shore Gas and MidAmerican as evidence of its reasonableness, and does so in light of the Commission's Orders in the 2007 Peoples Rate

Case and MidAmerican Energy's most recent rate relief request. 2007 Peoples Rate Case, Order at 261; *MidAmerican*, Docket No. 99-0534, Order at 40 (July 11, 2000) ("1999 MidAmerican Rate Case"), respectively. Moreover, the Commission, in approving a $25 NSF fee in the 2007 Peoples Rate Case, stated the fee "would serve to discourage payment with checks that are not valid." Thus, contrary to the positions taken by AG/CUB, the Commission has expressly approved a deterrent element within the NSF charge. 2007 Peoples Rate Case, Order at 261.

CUB's position that a NSF fee will result in double recovery is flawed. The revenues generated from the NSF charge serve to *reduce* the rates of customers who make valid payments thereby eliminating any concern regarding double recovery. Mudra Reb. Corr., Nicor Gas Ex. 29.0, 29:622-25. The rate reduction resulting from the collection of NSF fees counters CUB's double recovery claim.

AG/CUB's arguments in this proceeding are the same as those made in the 2007 Peoples Rate Case. In assessing those arguments, the Commission concluded: "[t]he Commission is not made aware of any good reason to abandon, in this instance, the logic that drove our result in the MidAmerican Energy case." 2007 Peoples Rate Case, Order at 261. Moreover, the Commission has recognized that in those instances where it is reasonable to do so, it would consider its past practice in resolving an issue. *Id*., Order at 199. Neither the AG nor CUB provides adequate reason for the Commission to abandon its past practice on NSF fees.

XIV. REVENUES

A. Total Billing Units / Rate 4 and Rate 74 Billing Units

Nicor Gas demonstrated that its calculation of total test year billing units was reasonable and appropriate. Nicor Gas Init. Br. at 128-30. Staff concurred, raising no objection to the manner in which the Company calculated its total test year billing units, or the allocation of that total among Nicor Gas' customer classes. Staff Init. Br. at 174. The AG, however, seeks to improperly inflate total test year billing units by manipulating the billing units allocated to the Rate 4 and Rate 74 customer classes. AG Init. Br. at 97-98. The evidence fails to support such manipulation and, therefore, the Commission should reject the AG's proposal.

As the Company fully explained in its Initial Brief, it first forecasts total billing units for a calendar year, and then allocates the total among its various customer classes. Nicor Gas Init. Br. at 128-29. The development of the forecasted total billing units, and the allocation among customer classes is based on historical usage trends, both for total billing units and for each customer class. Pepping Reb., Nicor Gas Ex. 31.0, 5:102-6:122; Pepping Sur., Nicor Gas Ex. 50.0, 3:60-70. Nicor Gas also demonstrated that it has been very accurate in forecasting total billing units, with an average forecast to normalized actual variance of only 1.5% over a 10-year period. Pepping Sur., Nicor Gas Ex. 50.0, 4:87-93; Nicor Gas Ex. 50.1. If anything, the Company has been conservative in its forecasts, as actual annual usage usually has been less than what was forecasted during that 10-year period. *Id.* In sum, the evidence demonstrates that the Company's forecast of total billing units and the allocation of that total are reasonable and should be approved.

Despite the guise of claiming that Rate 4 and Rate 74 billing units are too low, AG/CUB witness Effron's goal is clear: he seeks to inflate total billing units in order to reduce the Company's revenue requirement by $1,441,000. Nicor Gas Init. Br. at 128-30. Rather than applying the Company's "top-down" approach to forecasting total billing units, AG/CUB witness Effron used an inappropriate and partial "bottoms-up" approach in order to manipulate total billing units. Pepping Sur., Nicor Gas Ex. 50.0, 3:71-4:86. In particular, he claims that the Rate 4 and Rate 74 billing units must be adjusted upward, not based on an analysis examining the trend of historical customer usage patterns, but instead looking at an inadequate two year snapshot of usage for these two customer classes. *Id.*, 5:94-108. Using only this limited data, he concludes that an increase in billing units is warranted for the Rate 4 and Rate 74 customer classes, and a corresponding increase in total billing units is required as well. Effron Dir., AG/CUB Ex. 1.0, 16:6-18:8; Effron Reb., AG/CUB Ex. 4.0, 8:20-9:2; AG/CUB Ex. 4.1C, Sch. C-1.

As explained in the Company's Initial Brief, Mr. Effron completely ignores: 1) the "top-down" approach that Nicor Gas has used for more than a decade for forecasting total billing units; 2) the importance of using customer class historical usage trend data when allocating the total billing units to the various customer classes; 3) the Company's demonstrated accuracy in forecasting total billing units; and 4) the overwhelming evidence showing that Nicor Gas has and continues to experience a decline in usage per customer. Nicor Gas Init. Br. at 129-30. Mr. Effron's disregard of these four points results in a hopelessly flawed analysis.

While the evidence demonstrates that AG/CUB witness Effron's approach is improper and unreasonable, Mr. Effron suggests that his approach should be used because the Commission adopted his approach in the 2004 Rate Case. Effron Reb., AG/CUB Ex. 4.0, 7:16-8:4. This argument is a red-herring and should be rejected. In this case, Nicor Gas demonstrated that Mr. Effron's forecast used in the 2004 Rate Case clearly was less accurate than the Company's forecast in that proceeding. Pepping Sur., Nicor Gas Ex. 50.0, 5:109-6:132. In fact, Mr. Effron's approach over-stated total billing units by 4.5%, which resulted in the Company suffering an annual revenue loss of $5.4 million since the conclusion of the 2004 Rate Case. *Id.*, 6:127-32. History has demonstrated that Mr. Effron's approach is flawed and should be rejected. Interestingly, the AG does not address this point in its Initial Brief.

In conclusion, there is no reasonable basis to adopt the AG's proposed upward increase to total billing units. Nicor Gas has shown that its forecasting methodology for total billing units and its allocation of the total among its customer classes is reasonable, and Staff has no objection to the approach. Meanwhile, the AG's result-oriented approach is improper and imprecise, and previously has resulted in unwarranted financial harm to the Company. As such, the AG's proposed adjustment to the Company's forecasted total billing units should be rejected.

B. Nicor Energy Services Billing Adjustment

1. Staff's Proposed Billing Adjustment for Nicor Energy Services Ignores the Cross-Examination Testimony of Staff's own Witness, as well as the Evidence Showing the Unique Nature of the Billing Service Provided to Nicor Energy Services

Staff's recommendation to impute a $0.25 per bill charge for a unique billing service that Nicor Gas provides to Nicor Energy Services ("Nicor Services") is contrary to the evidentiary record and the Company's Commission-approved Operating Agreement. Staff Init. Br. at 174-77. Staff's adjustment is premised on one claim:

> Staff recommends the Company's billings to Nicor Energy Services be charged at the prevailing rate, rather than fully distributed costs, *since it performs essentially the same services to Nicor Solutions and charges Nicor Solutions a prevailing rate*.

Id. at 174 (emphasis provided). The evidence, including the testimony of Staff's own witness, demonstrates convincingly that Staff is wrong. The respective billing services are not the same, and Nicor Services should not be charged a "prevailing rate," as the two services are not "essentially the same."

Nicor Gas does not provide the same billing service to Nicor Services and Nicor Solutions. Rather, it provides one billing service to Nicor Services and an entirely different billing service to Nicor Solutions, and does so under completely separate fee structures. Gorenz

Sur., Nicor Gas Ex. 45.0, 11:229-38, 10:215-24. Nicor Gas developed a billing service that is unique to Nicor Services - no other entity uses Nicor Services' billing service. *Id.*, 11:225-38. **[This is too Gorenz Sur. Correct?]** Staff witness Hathhorn agreed that no other party uses the service that is being provided to Nicor Services—a billing service that assesses a straight-forward recurring monthly fee. Tr. at 468:14-469:2. The billing service was programmed to address the specific needs of Nicor Services. Gorenz Sur., Nicor Gas Ex. 45.0, 11:229-38. Staff has presented no evidence, and there is none, which would contest this point.

In contrast, Nicor Solutions uses a completely different billing program, which also is used by various alternative retail gas suppliers under Nicor Gas' Customer Select program ("Customer Select suppliers"). *Id.*, 10:215-24. This billing program is far more complex than the one Nicor Services uses, requiring the assembly of individual customer consumption data to compute monthly bills. *Id.*, 11:235-38. Nicor Solutions is billed at the same rate as Customer Select suppliers, as Nicor Solutions offers a product that may be considered to be in competition with the sale of gas by Customer Select suppliers. Gorenz Sur., Nicor Gas. Ex. 45.0, 9:195-200. [**If other Id's are correct, this should be Id.]** Staff witness Hathhorn agreed that Nicor Solutions and Customer Select suppliers utilize the same billing system. Tr. at 469:3-11. Again, Staff has presented no evidence to contest these points.

Staff also incorrectly claims that using a different billing system is not enough to justify charging a fully distributed price to Nicor Services. Staff Init. Br. at 175. This claim should be rejected for two reasons. First, Staff offers no authority for its claim, because no such authority exists. Consequently, it is basing its adjustment on a non-existent standard. Second, Staff fails to acknowledge that the Company not only provided evidence about the differences in the billing service, but also presented evidence demonstrating the different manner in which Nicor

Solutions and Nicor Services were charged for their respective services. Unlike Nicor Solutions, Nicor Services paid an initial fee to establish the unique billing program. Gorenz Sur., Nicor Gas Ex. 45.0, 11:244-12:251. Also, Nicor Services pays a separate charge for ongoing system maintenance costs. *Id.* In contrast, Nicor Solutions (along with other Customer Select suppliers) pays only the $0.25 per bill charge—there was no initial start-up fee, nor is there an ongoing maintenance charge to Nicor Solutions. *Id.* This information was provided in response to Staff data request DLH 27.09, which was attached to Staff witness Hathhorn's rebuttal testimony. Hathhorn Reb., Staff Ex. 15.0, Att. E. However, no mention of these costs differences is found in the body of that testimony. Notably, Staff's Initial Brief also is silent on these points.

The facts are clear. Nicor Gas provides Nicor Services and Nicor Solutions with two separate and distinct billing services, under two separate fee structures. Pursuant to the Commission-approved Operating Agreement, Nicor Solutions is charged the "prevailing rate" of $0.25 per bill, as this is the charge assessed to Customer Select suppliers for using of the same billing system. Gorenz Sur., Nicor Gas Ex. 45.0, 10:215-24. Meanwhile, there is no prevailing rate for the unique billing service provided to Nicor Services, as the service is not offered to the general public. *Id.*, 9:180-82, 11:225-38. In this regard, Staff witness Hathhorn agreed that use of a fully distributed charge is appropriate where Nicor Gas does not offer a service for sale to the general public. Tr. at 468:14-469:2. Accordingly, pursuant to the Operating Agreement, Nicor Gas is properly charging Nicor Services the fully distributed cost for the service, or $0.112 per bill, plus start up and ongoing maintenance fees. Importantly, in charging the fully distributed cost for the service, ratepayers are not subsidizing the service. Hence, customers are not negatively impacted, which is another point that Staff fails to address.

Finally, Staff makes a claim that the billing charge should not be approved in this proceeding simply because the charge comports with the Operating Agreement. Staff Init. Br. at 175-76. Staff misses the point. The Company is not relying solely on the Operating Agreement. As demonstrated above, the evidence makes clear that the billing service being provided to Nicor Services is far different, both in the service itself and the fee structure, than the service being provided to Nicor Solutions and various Customer Select suppliers. For all of these reasons, therefore, the Commission should reject Staff's proposal to impute a charge to Nicor Services that is unreasonable.

XV. GROSS REVENUE CONVERSION FACTOR

This matter has been resolved between Staff and the Company. *See* Staff Init. Br. at 177, 19. Meanwhile, the AG seeks an amendment related to its proposed uncollectible expense rate. AG Init. Br. at 98. As explained in Nicor Gas' discussion of the appropriate uncollectible expense rate, Subsection V.C.2 herein, the AG's proposal should be rejected.

XVI. OTHER ISSUES

A. Accounting for Storage Gas Losses

Staff's Initial Brief presents 13 pages of discussion on what has become an uncontested issue. Staff Init. Br. at 177-90. While Nicor Gas and Staff have disagreed on various elements of this issue, the Company, in the interest of narrowing the issues, ultimately accepted Staff's proposal to modify, on a prospective basis, the manner in which it accounts for storage gas losses. Nicor Gas Init. Br. at 133-34. As Staff indicated, this would not result in any adjustments in this proceeding. Staff Init. Br. at 178.

Specifically, Nicor Gas witness Bartlett testified that the Company would transition from its current approach for accounting for storage gas losses no later than July 1, 2009. Bartlett Reb., Nicor Gas Ex. 19.0, 7:162-11:259, Bartlett Sur., Nicor Gas Ex. 38.0, 9:201-16:356. Under this approach, the Company agrees to account for two types of storage gas losses, 1) "physical loss" and 2) losses not attributable to specific causes, consistent with the accounting procedures that Staff recommends. Gorenz Reb. Corr., Nicor Gas Ex. 26.0, 51:1105-55:1196; Gorenz Sur., Nicor Gas Ex. 45.0, 13:275-14:295. The Company also will develop written procedures related to tracking these two types of losses and implement these procedures no later than July 1, 2009. Bartlett Sur., Nicor Gas Ex. 38.0, 9:201-16:356.

B. Reporting of Affiliate Transactions

As reflected in the Initial Briefs of Nicor Gas and Staff, this matter is resolved. Staff Init. Br. at 190; Nicor Gas Init. Br. at 135.

C. Operating Agreement

As reflected in the Company's Initial Brief, Nicor Gas has no objection to the Commission initiating an investigation into its current, Commission-approved Operating Agreement. Nicor Gas Init. Br. at 135. In its Initial Brief though, Staff now recommends that the Company file a petition to initiate a proceeding either to gain "re-approval" of the current Operating Agreement or approval of a new "affiliated interest transaction agreement." Staff Init. Br. at 191. Nicor Gas has no objection to Staff's modified proposal.

XVII. CONCLUSION

The Initial Briefs of Staff and the Intervenors fail to rebut the reasonableness of Nicor Gas' proposals in this proceeding. The Commission should approve Nicor Gas' proposals, as they are just and reasonable, conform with the law and are fully supported by the evidence. Commission approval will provide Nicor Gas with the opportunity to recover its prudent and reasonable cost of service, and allow the Company to continue to efficiently serve customers while remaining Illinois' low cost provider of natural gas distribution.

Dated: January 9, 2009

Respectfully submitted,

NORTHERN ILLINOIS GAS COMPANY
D/B/A NICOR GAS COMPANY

By: /s/ John E. Rooney
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CERTIFICATE OF SERVICE

I, John E. Rooney, hereby certify that I caused a copy of the Reply Brief of Nicor Gas Company to be served upon the service list in Docket No. 08-0363 by email on January 9, 2009.

/s/ John E. Rooney
John E. Rooney