STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company	**)**	
d/b/a Nicor Gas Company	**)**	**08-0363**
	)	
Proposed general increase in natural gas rates.	**)**	

APPLICATION FOR REHEARING OF

THE CITIZENS UTILITY BOARD

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Dated: April 24, 2009

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Pursuant to Section 200.880 of the Rules of Practice[1] of the Illinois Commerce Commission ("Commission" or "ICC"), the CITIZENS UTILITY BOARD ("CUB") hereby submits this Application for Rehearing. CUB respectfully requests that the Commission reverse its decision regarding the residential rate design approved for Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor" or the "Company") in its final Order in this proceeding, issued on March 25, 2009.

I. INTRODUCTION

The Commission committed reversible error in approving a dramatic increase in unavoidable monthly charges Nicor's customers must pay each month, which is not supported by substantial evidence in the record, and leads to unjust residential delivery rates. Pursuant to the Public Utilities Act ("PUA"), "the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility." 220 ILCS 5/9-201(c). The PUA further demands that "all rates or other charges...shall be just and reasonable." 220 ILCS 5/101. The Commission ignored substantial evidence in approving an unreasonable increase in Nicor's fixed

[1] 83 Ill. Adm. Code Part 200.880

residential customer charge, incorrectly relying on a faulty premise and ignoring the disparate impact such increase has on Nicor's customers.

In granting Nicor's modified straight fixed variable ("SFV") rate design for residential customers, the Commission relied on the fictional problem of fixed cost recovery, despite no evidence of this fact and despite contrary evidence that Nicor has in fact recovered more fixed costs, on average, from residential customers than it assumed it would in its last rate case. AG/CUB Ex. 3.0 at 18, LL. 364-366. Further, the Commission's determination regarding residential customers' rate design challenges the concept of fairness with respect to low-income customers, violates the constraints of gradualism and rate shock with increases for some customers exceeding 100% in a single jump, conflicts with cost-causation principles and frustrates the goal of energy efficiency by denying customers the benefit of reducing usage and removing the price signals for consumption. The Commission should reconsider its adoption of Nicor's modified SFV rate design in order to avoid reversible error.

II. ARGUMENT

The Commission approved Nicor's proposed increase in the residential customer charge from $8.40 to $13.55 – over a 60% increase in one fell swoop. Order at 91. The Commission's stated rationale for approving this residential rate design is to allow Nicor to recover 80% of Rate 1 (residential) customer's fixed delivery service costs through the monthly customer charge of $13.55. Order at 90. In making this determination, the Commission committed reversible error in two fundamental ways. First, the Commission erred by accepting Nicor's invalid claim that it did not recover its fixed costs under its prior rates, and ignoring evidence to the contrary. CUB and Attorney General ("AG") witness Scott Rubin unequivocally showed that Nicor is, in fact, recovering its fixed costs under the rates in effect prior to the Commission's final Order in this docket (its "pre-existing" rates). Second, the Commission inappropriately dismissed the bill impacts analysis performed by Mr. Rubin, which demonstrated the disparate impact the Commission's adopted rate design imposes on residential customers.

A. NO "FIX" IS NECESSARY TO ALLOW NICOR TO RECOVER ITS FIXED COSTS

The Commission adopted a modified SFV residential rate design at least in part to better allow Nicor to recover its fixed costs. Order at 89. The Commission's rationale is erroneous for two reasons. First, not even Nicor itself alleges that it did not recover its fixed costs under its pre-existing rates. In its Reply Brief, Nicor stated that "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 Reply Br. at 71. Considering the Company over-collected its fixed costs under pre-existing rates, with a customer charge 60% *lower* than the approved customer charge in this case, Nicor apparently had more than sufficient "opportunity" to collect its fixed costs under pre-existing rates. Second, Mr. Rubin's analysis affirmatively demonstrates that any alleged inability to recover its fixed costs is fiction.

Mr. Rubin looked back at the rates the Commission authorized in Nicor's last rate case and the Commission determined to be the residential class' contribution in terms of fixed cost recovery. Using Nicor's actual sales data, AG/CUB witness Rubin estimated Nicor's actual level of fixed cost recovery per customer from distribution charges during the 24 months prior to the date of his testimony. The result of this analysis is shown on AG/CUB Exhibit 3.06. Mr. Rubin's uncontroverted analysis of the data set of more than 1.3 million Nicor residential customers shows that Nicor actually recovered more fixed costs from these customers, on average, than it assumed it would in its last rate case. Specifically, in AG/CUB Exhibit 3.06, Mr. Rubin showed that Nicor recovered an average of $72.89 per customer in fixed costs from gas distribution charges. *Id.* at 11-12. This level of cost recovery exceeds Nicor's assumed level of collection of $70.05 per customer by more than $2.80 per customer per year. *Id.*

During the two years between rate cases, Nicor had sold slightly more gas per customer than it projected it would. In order to present a balanced analysis, therefore, Mr. Rubin went on to perform a calculation assuming – hypothetically – that Nicor actually sold *less* gas per customer than it projected in the last rate case. He testified that even if it is assumed that Nicor s calculation of sales per customer, presented as AG/CUB Ex. 2.04, is accurate, it still would not mean that Nicor suffered a serious under-recovery of its fixed costs that would justify either its proposed rate design or implementation of Rider VBA. AG/CUB Ex. 3.0 at 15, LL. 305-306. He concluded that this minor under-recovery ($5.67 million annually under his hypothetical example) would not require any special ratemaking treatment, such as the dramatic re-design of residential rates that the Commission approved in its final Order in this proceeding.

The Commission erroneously dismissed Mr. Rubin's analysis because the analysis reviews Nicor's last approved revenue requirement, rather than its actual costs. Order at 89. While it is true that the approved revenue requirement is an "estimate, based on the evidence presented, as to what a utility will need in order to recover that cost," a utility's cost may just as easily go up as down in the period between rate setting cases. And, in fact, the Company is *not* arguing that it needs the modified SFV rate design to fix a cost recovery problem. It simply wants more of a guaranteed revenue stream. Under Illinois law, however, Nicor is only allowed an opportunity – not a guarantee – to achieve its authorized return. *Bluefield Waterworks Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 279 (1923) (a utility's rates should reflect the opportunity – not a guarantee – to earn a return on its used and useful property when a commission sets rates).

Nicor does not establish that it is seriously under-recovering its fixed costs, nor can it, since Mr. Rubin's analysis demonstrates that Nicor is over-recovering its fixed costs and is earning almost exactly what the Commission approved in its last rate case. AG/CUB Ex. 5.02; AG/CUB Ex. 3.0 at 11-12, LL. 236-241; AG/CUB Ex. 3.06. In Nicor's last rate case, the Commission set a total Company distribution revenue requirement of $549,689,000. ICC Docket No. 04-0779, Order at 196. According to Nicor's schedules in the present docket, (Nicor Sch. E-5), total Company base revenues under present rates are $547,280,000 - a difference of only $2.4 million, which is less than ½ of 1% of its total revenue requirement. The difference is even smaller when examined in terms of residential rates. Nicor's existing rates were designed for Nicor to recover approximately $357.32 million from residential customers. The record in this docket reflects that Nicor is actually recovering within $1.1 million of the authorized level of total base rate revenue from residential customers: $356.25 million as compared to $357.32 million, a difference of just 0.3%. AG/CUB Ex. 5.0 at 5, LL. 106-108.

These small percentages of under-recovery do not warrant the punitive rate design adopted by the Commission, which severely punishes the lowest-use customers. This is highlighted by the fact that Nicor is actually *over-recovering* its fixed costs and has not lost significant amounts due to a decline in usage. Because the Commission's stated purpose in adopting the modified SFV residential rate design is actually based on a fictional problem, it goes against substantial evidence.

B. THE SFV RATE DESIGN ADOPTED BY THE COMMISSION VIOLATES FUNDAMENTAL RATEMAKING PRINCIPLES.

Mr. Rubin demonstrated that a full SFV rate design, where 100% of Nicor's fixed costs would be recovered in the customer charge, unfairly increases some bills by more than double, while reducing some bills by 50% or more. AG/CUB Ex. 3.0 at 7, LL. 148-149. Mr. Rubin therefore concluded that the SFV rate design is so radical that it should not even be considered. *Id*. at 7, LL. 147-148. The modified SFV rate design adopted by the Commission is similarly problematic and directly conflicts with several well-established ratemaking principles, such as gradualism, rate continuity, equity and non-discrimination. These principles require that changes in rates and rate structure be as gradual as possible (given the exigencies of changing costs), so that customers receive a consistent set of price signals (that can influence spending on long-term investments such as heating systems), and so that all customers are treated fairly, with no disparate treatments imposed on similarly situated customers. *Id*. at 7-8, LL. 151-158.

The increase to the residential customer charge to $13.55 is accompanied by a slight reduction to per therm volumetric charges and the elimination of the third consumption block (stated another way, the second and third volumetric blocks were consolidated). The Commission notes that the practice of increasing the fixed monthly charge and decreasing the volumetric charge is "essentially a revenue neutral exercise." Order at 90. Although revenue neutral perhaps, this radical rate re-design is not rate neutral. That is, it has real impacts on real customers and imposes the largest percentage increases on customers with the lowest levels of consumption. AG/CUB Ex. 3.0 at 6, LL. 119-120. The impacts are quite extreme and such a dramatic change in residential rate design should have been accompanied by a customer-impact analysis that shows the effects of the proposal on real customers. Nicor did not present such an analysis. Substantial evidence does not, therefore, support the Commission's adoption of the modified SFV rate design.

C. THE COMMISSION INAPPROPRIATELY DISMISSED STAFF'S ARGUMENTS AGAINST THE SFV RATE DESIGN APPROACH

The Commission's own Staff opposed the SFV rate design and argued that the modified SFV rate design sends the wrong message to residential consumers, because it provides a disincentive for customers to conserve their use of natural gas. Staff Brief on Exceptions at 11. Staff witness Peter Lazare testified that, "[w]ith a greater share of revenues recovered through the fixed, non-bypassable customer charge, an SFV-based rate design reduces the amount of savings that ratepayers can realize by conserving gas. Thus, the price signal for ratepayers to conserve this resource is weakened." Staff Ex. 7.0 at 34, LL. 750-753. The Commission rejects this argument by noting that "[d]uring periods of rising fuel costs that result in consumer conservation of the gas commodity, the utility under-recovers its fixed costs of delivery." Order at 91. That may be theoretically true, but there is no evidence of it in this proceeding with regard to Nicor, as discussed above, and thus the Commission's stated rationale for rejecting Staff's arguments regarding conservation is faulty.

Staff further argued that the modified SFV rate design also distorts cost-causation principles by ignoring the distinctions between, and proper allocation of, customer costs and demand costs, such as distribution mains. *Id*. at 37, LL. 810-811. The SFV approach fails to consider the relative share of distribution facilities that are utilized by different customers. Cost-causation principles dictate that customers pay only for that portion of the system that they use.

Under a SFV rate design, smaller customers are required to pay the same as larger customers for certain plant components despite their smaller contribution to these costs. *Id*. at 39, LL. 845-847.

Finally, Staff correctly noted an important public policy reason for rejecting the modified SFV rate design: a substantially higher customer charge makes it more difficult for ratepayers in financial distress to control their natural gas costs by "dialing down" their thermostat. Because a SFV rate design recovers a larger share of distribution costs through a fixed customer charge, it reduces the portion of the bill that ratepayers can control through their consumption patterns. *Id*. at 39, LL. 851-853. The Commission dismissed this argument by rationalizing that customers would have a more accurate prediction of their bill and any effect on their bills would be negligible. Order at 90. But in these times of economic crisis, the Commission should be even more cognizant of the disparate impact this rate structure will have on low-use customers.

D. AG/CUB Witness Rubin's Equal, Across-the-Board Modification of Rates Is Supported By the Record Evidence and Reasonable in Application.

AG/CUB witness Rubin has proposed an equal across-the-board modification of rates, whereby any rate increase or decrease should be applied to each element of Nicor's residential rates (the customer charge and three distribution block charges) by the same percentage increase or decrease as the residential class's overall rate increase. AG/CUB Ex. 3.0 at 18, LL. 367-369. Across-the-board increases would preclude disparate bill impacts for different types of customers. Nicor currently recovers most of its additional fixed costs through the first consumption block (the first 20 therms per month) under a rate structure that the Commission has already ruled is just and reasonable in Nicor's last rate case. AG/CUB Ex. 3.0 at 10, 14, 15, LL. 283-287, 313-315. Mr. Rubin's rate design proposal maintains the exact same structure that has allowed Nicor to recover its fixed costs. Thus, the Commission's conclusion that Mr. Rubin's residential rate design proposal ignores the Company's fixed cost recovery issues and intraclass subsidies are incorrect. Order at 89.

Any rate increase or decrease should be borne in equal proportion to the magnitude of the rate change itself. By doing so, the Commission will take into account important public policy considerations, such as customer impact, the overall fairness of the result, rate continuity, gradualism, and other factors relevant to producing just and reasonable rates that avoid disparate rate increases for Nicor's customers – factors that the Commission's Order does not adequately take into account. Under Mr. Rubin's approach, customers receive a consistent set of price signals that can influence spending on long-term investments, such as heating systems. It treats all customers fairly, with no disparate treatments imposed on similarly situated customers, unlike the rate design adopted by the Commission. *Id*.

II. CONCLUSION

The Commission's approval of a modified SFV rate design for residential customers destroys any notion of ratemaking integrity, as it will cause many low-use customers to pay more on an annual basis, while some high-use customers pay less. On the other hand, Mr. Rubin's proposal for monthly charges increases the customer charge by no more than 31.36%, while providing cost recovery through modified distribution rates.

The Company failed to sustain its burden of proving that the pre-existing rate design did not permit it to recover its fixed costs. In fact, the record shows that Nicor was actually over-recovering its fixed costs under its prior rates. If the Commission is to approve any changes to residential rates, they must be made to the customer charge and the distribution block charges equitably, on an across-the-board basis to satisfy the just and reasonable standard provided in Section 9-101 of the Public Utilities Act. 220 ILCS 5/9-101. CUB urges the Commission - to avoid reversible error - to reverse the determination it made in its final Order regarding residential delivery rates and instead adopt the rate design proposal of AG/CUB witness Rubin.

Respectfully submitted,

CITIZENS UTILITY BOARD

Dated: April 24, 2009

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