DIRECT TESTIMONY

of

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North Shore Gas Company and
The Peoples Gas Light and Coke Company

Proposed General Increase
in Gas Rates

Docket Nos. 09-0166/09-0167 (Cons.)

June 10, 2009

Introduction

Q. Please state your name and business address.

A. My name is Peter Lazare. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. What is your present position?

A. I am a Senior Rate Analyst with the Illinois Commerce Commission ("Commission"). I work in the Financial Analysis Division on rate design and cost-of-service issues.

Q. What is your experience in the regulatory field?

A. My experience includes seventeen years of employment at the Commission where I have provided testimony and performed related ratemaking tasks. My testimony has addressed cost-of-service, rate design, load forecasting and demand-side management issues that concern electric, gas and water utilities.

Previously, I served as a Research Associate with the Tellus Institute, an energy and environmental consulting firm in Boston, Massachusetts. I also spent two years with the Minnesota Department of Public Service as a Senior Rate Analyst, addressing rate design issues and evaluating utility-sponsored energy conservation programs.

Q. Please discuss your educational background.

A. I received a B.A. in Economics and History from the University of Wisconsin and an M.A. in Economics from the University of Illinois at Springfield in 1996.

Q. What is the subject of your testimony in this proceeding?

A. My testimony focuses on two riders proposed by North Shore Gas Company ("North Shore") and The Peoples Gas Light and Coke Company ("Peoples Gas") (individually, the "Company" and collectively, the "Companies") in this case. The first is Rider ICR (Infrastructure Cost Recovery) which is proposed for Peoples Gas only and second is Rider UEA (Uncollectible Expense Adjustment) for both Peoples Gas and North Shore.

Q. What do you recommend for these two riders?

A. I recommend that both be rejected by the Commission.

Q. How is your discussion organized?

A. I discuss Rider ICR first and then Rider UEA.

Q. Have you prepared any schedules as part of your testimony?

A. Yes, I have prepared the attached Schedule 1 which presents monthly Chicago City-Gate gas prices for 2008 and 2009.

Rider ICR

Q. What is Rider ICR?

A. The proposed rider is described by Company witness Grace as follows:

> Peoples Gas's proposed Rider ICR will recover costs associated with the replacement of cast iron and ductile iron main and connecting facilities including services, meters and regulators. It will also recover the costs of other mains, citygate stations, regulator stations and incremental operation and maintenance expenses related to the replacement program. Costs recoverable under Rider ICR will be offset by savings that are estimated to be generated by the replacement program. (Peoples Gas Ex. VG-1.0, p. 35)

Q. Company witness Schott states proposed Rider ICR is "consistent with points raised by Staff in the last rate case," and "includes many of the modifications proposed by Commission Staff in that case." (Peoples Gas Ex. JFS-1.0, p. 13) Please comment.

A. Staff's primary position in the previous case was that the need and justification for rider recovery of certain costs through Rider ICR in that docket had not been established and was not supported by the evidence. However, Staff recommended changes to Rider ICR that were designed to mitigate the adverse impacts of a proposal that Staff considered to be fundamentally flawed in the event the Commission decided to approve the rider. Nothing in Staff's testimony in the prior docket suggested that it would support Rider ICR if the recommended changes were made.

Q. Mr. Schott indicates that capital has become "more expensive to obtain" in the current financial crisis. Thus, he considers the proposed Rider ICR which provides greater "certainty of recovery on and of the investment in cast iron main" essential to "to keep the capital costs associated with the infrastructure improvement reasonable." (Peoples Gas Ex. JFS-1.0, p. 14) Please comment.

A. This argument amounts to an unsupported assertion on Mr. Schott's part. He provides no specific evidence concerning what the capital costs for the program would be with and without Rider ICR.

Q. Peoples witness Marano presents testimony which he indicates is designed to support the proposed Rider ICR.. (Peoples Gas Ex. SDM-1.0, p. 2) Please comment.

A. It is not clear how Mr. Marano's testimony supports the adoption of a rider to collect infrastructure costs. He focuses instead on the need for an accelerated program to replace the current network of cast iron and ductile iron mains and how that can best be accomplished. However, he does not discuss why a rider mechanism is needed to recover the associated costs. Mr. Marano is clear on this matter. He begins by stating:

> My testimony will provide my opinion and support for the accelerated replacement of PGL's gas mains and services infrastructure, based on the need for reduction of future risk to the public, the public good created by a modern asset-based gas distribution system and the economic advantages of an accelerated program. (Peoples Gas Ex. SDM-1.0, p. 3)

Mr. Marano states the "analysis of regulatory mechanisms to allow companies to both recover their costs of system modernization a well as to flow reduced system costs back to customers" is presented by Company witnesses Schott and Grace. (Peoples Gas Ex. SDM-1.0, pp. 3-4)

There are two outstanding issues concerning the accelerated infrastructure replacement program. One issue concerns whether the program is needed. If the answer is yes, the second issue concerns how the program should be funded. Mr. Marano's testimony addresses the first issue concerning whether the accelerated program is justified.

However, even if an accelerated program can be supported, that does not provide a compelling case for a rider mechanism. The normal mechanism for recovering infrastructure investments of any kind is base rates and if an alternative approach were necessary, the Company would have to argue accordingly. However, Mr. Marano does not explain why a rider mechanism would be justified in this case over traditional recovery through base rates. Therefore, I do not believe his testimony supports the proposed Rider ICR.

Q. Do you have additional comments regarding the proposed rider?

A. Yes. I am concerned that the Company seeks funding for an accelerated replacement program that has yet to be developed. Peoples Gas seeks the funding mechanism first and only after the funding mechanism is approved will it develop a plan to spend the funds. For example, the testimony of Company witness Marano focuses on why an accelerated replacement program is needed and what he believes is the preferred approach. However, "Mr. Marano's testimony does not purport to describe an implementation plan already fully developed by PGL". (Peoples Gas Response to PL 2.12)

Furthermore, the Company has explicitly stated that "[a]t this point, without knowing whether Rider ICR will be approved, Peoples Gas has engaged only in preliminary discussions regarding an accelerated program implementation plan such as described in Mr. Marano's testimony." (Peoples Gas Response to PL 2.11(a))

It is difficult to assess the need for a recovery mechanism without knowing the Company's funding needs for that rider. The Company has not provided a detailed explanation of how its accelerated main replacement program will be implemented. The Company should present its implementation plan before any extraordinary recovery mechanism is considered. Then, the Commission could assess that plan and decide whether it is sufficiently well-conceived to justify the adoption of an extraordinary rider recovery mechanism.

If consideration of an extraordinary recovery mechanism depended on the preparation of a reasonable plan for an accelerated main replacement program, then there would be a clear incentive to develop an acceptable plan to support rider recovery.

Q. Finally, in discussing Rider ICR, are you presenting any conclusions about whether an accelerated program is necessary to replace cast iron and ductile iron mains on the Peoples Gas system?

A. No. I am not presenting any conclusions concerning the need for an accelerated program or the best approach to implementing such a program. My argument concerns the appropriate recovery mechanism for the costs of an accelerated program if it were deemed necessary. Staff witness Harold Stoller (ICC Staff Ex. 14.0) addresses whether an accelerated program is necessary to replace cast iron and ductile iron mains on the Peoples Gas system.

Rider UEA

Q. Please explain Rider UEA proposed by Peoples Gas and North Shore.

A. The proposed rider is targeted to sales customers and would separately recover uncollectibles costs associated with their gas purchases. According to Companies' witness Grace, the share of uncollectibles costs in purchased gas costs would be determined in this case for each customer class. Then, that percentage applied to each monthly total of gas costs for the customer produces the level uncollectibles costs to be recovered through the rider. (Peoples Gas Ex. VG-1.0, p. 34; North Shore Ex. VG-1.0, p. 31)

Q. Does Ms. Grace cite a precedent by any other Illinois utility for this recovery approach?

A. Yes. She indicates that the Commission approved a similar approach (Rider UF) for ComEd in its most recent rate case, Docket No. 07-0566. (Peoples Gas Ex. VG-1.0, p. 35; North Shore Ex. VG-1.0, p. 31)

Q. How do you assess this citation to ComEd's uncollectibles rider?

A. The fact that ComEd has an uncollectibles rider is not sufficient reason for Peoples Gas and North Shore to have one also. Peoples Gas and North Shore must still explain why Rider UEA is an appropriate recovery tool that balances the interests of shareholders and ratepayers alike.

Q. Does Mr. Schott also discuss the proposed Rider UEA?

A. Yes. He presents a number of arguments for the rider. Mr. Schott begins by citing "volatility in gas costs" along with "the current financial conditions" and "the challenging economic circumstance of the service territory" to justify the proposed rider. (Peoples Gas Ex. JFS-1.0, p. 14; North Shore Ex. JFS-1.0, p. 12)

Q. Do you consider these arguments persuasive?

A. No, I do not. The recent volatility in gas costs has been to the downside. The attached Schedule 1 presents Chicago City Gate gas prices for 2008 and 2009 to date. The data indicates that average monthly gas prices for the first half of 2009 have declined by more than half from the corresponding period of 2008, $4.21 versus $ 9.52 per dekatherm. This decline in gas costs reduces the level of the uncollectibles problem for the Companies and thereby undermines the argument for an extraordinary rider mechanism to recover these costs.

Mr. Schott's discussion of current economic conditions generally and the specific conditions in the Peoples Gas and North Shore service territories also presents problems. He focuses on how the current economy impacts the Companies, but fails to consider the effects on ratepayers. Furthermore, Mr. Schott believes it acceptable in these difficult times to burden ratepayers with an uncollectibles risk that was previously borne by Peoples Gas and North Shore. Mr. Schott's one-sided argument on this issue should be rejected.

Q. Does Mr. Schott also cite volatility in uncollectibles costs as justification for the proposed rider?

A. Yes. He notes that actual uncollectibles expense and net write-offs both increased significantly from 2007 to 2008 for both Peoples Gas and North Shore. For Peoples Gas, he indicates that the actual levels rose by $15.9 million from $33.0 to $45.9 million and net write-offs increased by $23 million from $32.4 to $55.4 million. (Peoples Gas Ex. JFS-1.0, pp. 14-15) Mr. Schott goes on to present a chart of bad debt expense for Peoples Gas from 1997 through 2008 which seeks to demonstrate the volatility of these costs.

Q. How do you respond?

A. I would note that even with the increase in expenses claimed for 2008, the Company's charts show a level of bad debt expense in 2008 that remains below the peak established in 2002 and 2008 net write-offs are roughly even with 2002. (Peoples Gas Ex. JFS-1.0, pp. 15-16) Therefore, the 2008 level of uncollectibles is not unprecedented for Peoples Gas.

Q. What does Mr. Schott find for North Shore?

A. He indicates that the actual uncollectibles expense for North Shore rose by $190 thousand from $2.09 million to $2.28 million and net write-offs increased by $1.251 million from $1.637 to $2.888 million. (North Shore Ex. JFS-1.0, p. 2)

Q. How do you respond?

A. I would note that the 9% increase in uncollectibles costs Mr. Schott identifies for North Shore falls considerably short of the 33.67% increase in the overall revenue requirement proposed by the Company in this case. (North Shore, Part 285, Section 285.1, Schedule A-1, p. 2 of 7) Thus, it is not evident from these figures that the growth in uncollectibles is disproportionate and, thereby, worthy of rider treatment.

Q. Do you believe that these increases in uncollectibles for Peoples Gas and North Shore could be mitigated by a recent decline of natural gas prices?

A. Yes. As the attached Schedule 1 shows, gas costs this year are running so far at less than half the levels of 2008. These lower gas prices, by placing downward pressure on ratepayer bills, mitigate the uncollectibles problem in two ways. For one, lower bills make it easier for ratepayers to remain current on their utility payments and avoid falling into arrears. Second, those customers who don’t pay will generate a smaller level of uncollectibles due to the lower price of gas.

While gas costs are currently serving to mitigate the uncollectibles problem, it is difficult to predict what their impact will be in the future. If they remain low, the effect could be positive. However, if gas prices return to recent high levels, that could exacerbate the problem. Nevertheless, what is clear today is that gas prices cannot always be assumed to go up. So, it would be a mistake to approve Rider UEA in this docket based on the assumption that gas prices will necessarily rise in the near future and exacerbate the uncollectibles problem.

Q. Have the Companies themselves presented information that would call into question the need for Rider UEA?

A. Yes, that information comes from the Integrys earnings call for the fourth quarter of 2008. During the discussion, Larry Borgard, President and Chief Operating Officer of the Integrys Gas Group, assessed the uncollectibles issue as follows:

> We continue to monitor the bad debt situation at all of our gas distribution utilities, and our results reflect no material change. In absolute dollars, bad debt expense was up in the fourth quarter 2008, as well as for the full year versus the same periods in 2007. However, as a percent of revenues our diligent collection efforts kept us under control. (http://seekingalpha.com/article/123011-integrys-energy-group-inc-q4-2008-earnings-call-transcript?page=3, Viewed 6/2/09)

This discussion implies that the Integrys gas companies are able to manage their uncollectibles under the current regulatory paradigm which features base rate treatment for these costs. If the current approach is successful, it would be counterproductive to complicate the ratemaking process further by adopting an extraordinary rider mechanism for these costs.

Q. Please comment on Mr. Borgard's reference to "diligent collection efforts" to keep these costs under control.

A. As Mr. Borgard indicates, this is an important tool for controlling uncollectibles costs. To ensure that continues into the future, the Commission should maximize the incentive for Peoples Gas and North Shore to diligently continue these collection efforts.

Q. Would the Companies' proposed Rider UEA maximize the incentives to control uncollectibles costs?

A. No. The proposed rider would have the opposite effect of reducing those incentives by shifting the uncollectibles risk associated with gas costs from Peoples Gas and North Shore to ratepayers.

Q. Please explain.

A. Under the current regulatory paradigm, the Companies receive the opportunity to recover a fixed level of uncollectibles costs in base rates. If gas costs were to increase and uncollectibles rose as a result, the Companies would not be able to automatically pass along the higher uncollectibles costs to ratepayers. Their only alternative, short of filing a rate case, would be to search for ways to minimize uncollectibles costs. Thus, there would be a clear direct incentive to control these costs.

Approval of Rider UEA would change this dynamic. An increase in gas costs would be accompanied by an increase in the recovery of uncollectibles costs from ratepayers. These increased revenues under the rider would decrease the urgency for Peoples Gas and North Shore to control these costs. This would diminish the incentive to pursue the collection efforts necessary to control these costs.

Q. Does this complete your direct testimony?

A. Yes, it does.

Docket Nos. 09-0166/
09-0167 Consolidated
Staff Ex. 9.0
Schedule 1

Monthly City-Gate Prices
for Chicago
(in MMBTU)

	Price	
1/1/2008	7.2798	
2/1/2008	8.1116	
3/1/2008	9.3767	
4/1/2008	9.5949	
5/1/2008	10.8762	
6/1/2008	11.8528	
Jan-June Average		9.52
7/1/2008	12.885	
8/1/2008	8.9493	
9/1/2008	7.985	
10/1/2008	7.0426	
11/1/2008	6.1945	
12/1/2008	6.7696	
1/1/2009	6.2148	
2/1/2009	4.9246	
3/1/2009	4.0371	
4/1/2009	3.5379	
5/1/2009	3.1071	
6/1/2009	3.4187	
Jan-June Average		4.21

Source: Intercontinental Exchange