STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	Nos. 09-0166, 09-0167 Cons.
	:	
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	

Rebuttal Testimony of

VALERIE H. GRACE

Manager, Gas Regulatory Services
Integrys Business Support, LLC

On Behalf of
North Shore Gas Company and
The Peoples Gas Light and Coke Company

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I. INTRODUCTION AND BACKGROUND

A. Identification of Witness

Q. Please state your name.

A. My name is Valerie H. Grace.

Q. Are you the same Valerie H. Grace who submitted pre-filed Direct Testimony on behalf of The Peoples Gas Light and Coke Company ("Peoples Gas") and North Shore Gas Company ("North Shore") (together, "the Utilities") in this consolidated Docket?

A. Yes.

B. Purpose of Testimony

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

A. The purpose my testimony is to respond, in part, to the direct testimonies of Illinois Commerce Commission ("Commission") Staff ("Staff") witnesses Richard W. Bridal II, Christopher L. Boggs, Cheri L. Harden, Dianna Hathhorn, Peter Lazare, and David Sackett; Illinois Attorney General, Citizens Utility Board and City of Chicago ("AG/CUB/City") witness Scott J. Rubin; and Retail Gas Suppliers ("RGS") witness James L. Crist. In their respective rebuttal testimonies, other of the Utilities' witnesses also address some of these witnesses' testimony.

C. Summary of Conclusions

Q. Please summarize the conclusions of your rebuttal testimony.

A. Based on my review of the above mentioned testimony, I have reached the following conclusions:

A. The Utilities' rate design proposals are consistent with their stated objectives and are theoretically sound.

B. The rate design proposals made by Staff witness Ms. Harden are reasonable in some respects but not fully developed or vague in others.

C. The tiered rate design proposals made by AG/CUB/City witness Mr. Rubin are not fully developed, nor theoretically sound and would hamper the Utilities' ability to recover their revenue requirements.

D. The demand-based rate designs developed by Mr. Rubin are more reasonable than his tiered rate proposals but could result in unfavorable impacts for both the Utilities and their customers.

E. The rate design proposals made by Mr. Rubin are supported by selective and flawed use of the Utilities' data.

F. Certain observations, recommendations and proposals made by Staff witness Mr. Sackett are reasonable while others are without basis, incomplete or unclear.

G. A recommendation made by Staff witness Mr. Boggs would be acceptable to North Shore with a minor revision.

H. Most proposals made by Staff witness Ms. Hathhorn are reasonable while others are made moot by other Utilities' witnesses' testimony or are problematic.

I. The recommended changes to Rider UEA made by Staff witness Mr. Bridal II as well as the Utilities' agreement to such recommendations would be affected by pending legislation.

J. Staff witness Mr. Lazare's observation regarding Rider UEA is directionally biased.

K. RGS witness Mr. Crist's proposals for the Utilities' Choices For You[sm] ("CFY") programs are without merit.

D. <u>Itemized Attachments to Rebuttal Testimony</u>

Q. Are you sponsoring any attachments to your rebuttal testimony?

A. Yes.

Q. Please briefly describe the exhibits attached to your rebuttal testimony.

A. The following exhibits are attached to my rebuttal testimony:

1. NS-PGL Ex. VG-2.1P illustrates the potential (cost recovery) revenue shortfall that could arise for Peoples Gas from Mr. Rubin's tiered rate proposal. NS-PGL Ex. VG-2.1N illustrates the same issue for North Shore[1].

2. NS-PGL Ex. VG-2.2 provides the detail for Tables 1 and 2 in my rebuttal testimony, which summarize the bill impacts that would arise for Peoples Gas and North Shore customers from Mr. Rubin's tiered rate proposal.

3. NS-PGL Ex. VG-2.3P is an excerpt from Peoples Gas' response to CLH-1.01 which shows billing impacts for S.C. No. 2, Meter Class 3 sales customers. NS-PGL Ex. VG-2.3N provides similar data for North Shore.

4. NS-PGL Ex. VG-2.4 provides an analysis of and dispels the rate shock claim made by Ms. Harden.

[1] An "N" or a "P" at the end of the name of an exhibit means that it applies to North Shore or Peoples Gas, respectively.

5. NS-PGL Ex. VG-2.5P shows the derivation of a storage credit for Peoples Gas' Riders FST and SST. NS-PGL Ex. VG-2.5N shows the same for North Shore.

6. NS-PGL Ex. VG-2.6 provides an example of how a CFY storage credit would be computed on a per therm of Maximum Daily Quantity ("MDQ") basis as proposed by Mr. Sackett.

II. SERVICE CLASSIFICATIONS

Q. Staff witness Ms. Harden generally addressed the Utilities' proposed rate designs for all their service classifications, and AG/CUB/City witness Mr. Rubin addressed Service Classification ("S.C.") No. 1, Small Residential Service. Staff witness Mr. Sackett addressed an element of the rate design for the commercial and industrial customer classifications. Please provide an overview of your response to their testimonies.

A. In my rebuttal testimony I will show that certain rate design proposals made by Ms. Harden, Mr. Rubin and Mr. Sackett are not fully developed, vague or selective while others have elements of a rate design that would meet the objectives outlined in my direct testimony and that are feasible to implement. I will also show how I reached the conclusions stated previously in my testimony.

Q. Have you prepared new rates based on the revised revenue requirements to which other of the Utilities' witnesses are testifying?

A. No, I have not yet finalized new rates based on the revised revenue requirements to which the other Utilities' witnesses are testifying.

Q. Is your testimony detailed and specific enough that it would be straightforward to derive rates from whatever revenue requirements the Commission approves?

A. Yes. My direct testimony and rebuttal testimony are detailed and specific enough that it would be straightforward to derive rates from whatever revenue requirements the Commission approved.

Q. Will the Utilities be able to satisfy Ms. Hathhorn's recommendation, on page 45 of her direct testimony, that the Utilities provide the information needed to set Rider VBA rate case margins?

A. The Utilities may be able to provide updates as the case progresses provided that sufficient information is available to develop charges that would arise from such updates. The Utilities will provide final Rider VBA rate case margins, which are based on approved distribution charges, to the Commission with their compliance filings.

Q. Ms. Harden opposed, for all service classifications, the Utilities' proposal to recover Account 904 Uncollectible Accounts Expense ("Account 904 Costs") through the customer charge. Have you addressed this proposal in your testimony?

A. Yes. In my direct testimony I provided two reasons why gas cost related Account 904 Costs should be collected through the customer charge rather than the distribution charge. The primary reason is that Account 904 Costs are classified by the Utilities as customer related costs. The Utilities' witness Ms. Hoffman Malueg addresses the appropriate classification of Account 904 Costs in her direct and rebuttal testimonies. The second reason arises from the migration of sales customers to transportation service since the Utilities' last rate case proceedings, which has skewed the differentiation of the costs between sales and transportation service.

Q. How does providing the differentiation of Account 904 Costs in the distribution charge rather than the customer charge skew the differentiation of costs between sales and transportation service and how does it affect the Utilities and their customers?

A. A differentiation of Account 904 Costs in the distribution charges would be determined by using the test year distribution ("consumption") volumes and the blocking of such distribution volumes separately for sales and transportation customers in the test year. A significant migration from sales to transportation service, such as that which has occurred since 2006, would result not only in a large difference in distribution volumes between sales and transportation customers, but also a difference in the blocking of such volumes and the resulting distribution revenues. Any differences in the distribution revenues arising from migration would be reflected in distribution revenues that are used to determine adjustments under Rider VBA (Volume Balancing Adjustment). These differences could result in the Utilities' recovering or refunding amounts under Rider VBA due to customer migration from sales to transportation service and vice versa. Parties in this proceeding, including the Commission Staff, have inquired about different Rider VBA adjustments for sales and transportation customers under the same rate class. Customer migration and the different distribution charges between sales and transportation customers contribute to such differences. Mr. Sackett, in his direct testimony (page 8), recognizes the impact of customer migration between rate classes on Rider VBA adjustments and considers it a valid reason to implement eligibility requirements. While the Utilities are not proposing to prevent customers from electing transportation service or returning to sales service to minimize impacts on Rider VBA, providing for the differentiation of Account 904 Costs in the customer charge rather than the distribution charge would result in the same Rider VBA adjustments for sales and transportation customers under the same rate class. It would also result in two, rather than four, Rider VBA baselines for each Utility, and would eliminate any concerns about differing adjustments for sales and transportation customers within the same rate class.

Q. Is this a flaw with Rider VBA?

A. No. Rider VBA provides for calculating adjustments easily and accurately, and customer migration does not affect the accuracy of the calculations. However, the results of the calculations show differences between sales and transportation customers that could be eliminated through the Utilities' proposal. Rider VBA is not the issue, but the Rider VBA adjustments illustrate the customer migration issue.

Q. How do you respond to Ms. Harden's description of the migration issue on page 5 of her direct testimony, as a "new argument [that] appears to incorrectly imply that sales customers who have migrated to transportation are somehow paying less than they ought to simply because Account 904 costs are not solely allocated to the customer charge."?

A. The Utilities have not directly stated nor implied that transportation customers are paying less than they ought to because of the Account 904 allocation. To dispel any concerns, the transportation customers are not paying less than they ought to because of the allocation, but that does not mean the allocation is sound. The underlying reasons for the Utilities' proposals are stated clearly in my direct testimony and are reiterated above. The migration issue was also raised on page 16, lines 344-357 in my surrebuttal testimony in Peoples Gas' and North Shore's last rate cases, Docket Nos. 07-0241/07-0242 (cons.), where I stated the following in response to the Commission Staff's initial proposal to differentiate distribution charges for Account 904 Costs:

> "Q. Are there any other issues that would need to be addressed if the Commission were not to approve Rider UBA?
>
> A. Yes. Without the approval of Rider UBA, the Companies would have different distribution rates for sales and transportation customers. Therefore, these differences would need to be reflected in Riders VBA and WNA. If the differences were accounted for in the distribution charge, Rider VBA would need to reflect additional Rate Case Margin categories and Rider WNA would need to reflect different Base Rate, Base Load Sales and Heat Factors for sales and transportation customers. However, as customers can freely move between sales and transportation, it would be extremely difficult to set different parameters for sales and transportation customers. Therefore, if the Commission does not approve Rider UBA, but approves Rider VBA or Rider WNA, the Companies would propose for simplicity, any adjustments for gas cost related uncollectible accounts expense be made on a per customer rather than on a per distribution therm basis."

Riders WNA and UBA, referenced in the quotation, were proposals that the Commission did not approve and are not relevant to the point I am making about Rider VBA. The Utilities' concerns about the Account 904 Costs allocation, including the effect of customer migration on Rider VBA, are not new. While the Commission did not agree with the Utilities in the prior case, with experience under Rider VBA, it is appropriate to revisit these concerns about Account 904 Costs allocations.

Q. Some of Ms. Harden's rate design proposals are based on her conclusion, on page 9 of her direct testimony, that Rider VBA "should be maintained as designed" so that it can be assessed at the end of the pilot program period. Do you agree that the existence of Rider VBA as a decoupling pilot program should affect rate design for S.C. Nos. 1 and 2, which are subject to Rider VBA?

A. No. Rider VBA has been approved on a pilot basis with the pilot set to expire in March, 2012, unless the Commission grants permission for it to be permanent in a general rate proceeding. The Utilities' rate design proposals result in modest increases in fixed cost recovery for the test year, where Peoples Gas and North Shore would recover about 48% and 56%, respectively, through fixed charges. These proposals would leave a significant amount of distribution revenues, nearly $300 million for Peoples Gas and $40 million for North Shore, that would be subject to Rider VBA, and available to measure the experience of the pilot programs. Moreover, the Utilities' rate design proposals, if approved, would leave the Utilities less vulnerable to not recovering their approved revenue requirement after the pilots end. The distribution revenues cited above are significantly higher than the Utilities' variable costs, about $15 million for Peoples Gas and $695,000 for North Shore, which should be recovered through variable charges. Without an increase in fixed cost recovery, the Utilities' largely fixed costs would be recovered through largely variable charges after the pilots end. Even with the proposed increase, a significant percentage will continue to be recovered through variable charges. The Commission has addressed this type of mismatch by increasing fixed cost recovery to 80% for other Illinois gas utilities, a percentage that is much higher than those arising from the Utilities' proposals.

Q. Also is Ms Harden correct, with respect to Rider VBA, when she states on page 8 of her direct testimony, that the refunds that you testified have occurred under Rider VBA appear to have occurred through the annual reconciliation adjustments and not the monthly adjustments?

A. No, Ms. Harden is incorrect. In my direct testimony, I cite refundable Rider VBA amounts for Peoples Gas and North Shore that will have been refunded through monthly adjustments from May, 2008 through February, 2009. Annual reconciliation adjustments under Rider VBA are billed over a 10-month cycle beginning March 1 of each year. Accordingly such reconciliation adjustments did not become effective, and were not billed, until March 1, 2009, which is after the Utilities filed their requests for rate increases in this consolidated proceeding.

Q. Do you agree with Ms. Harden, who on page 8 of her direct testimony, appears to imply that the magnitude of the annual reconciliation adjustments is unaffected by the amount of distribution revenue that would be subject to Rider VBA?

A. No. Monthly adjustments as well as annual reconciliation adjustments are affected by the magnitude of the distribution revenues that are subject to Rider VBA. If more fixed costs were to be recovered through higher volumetric distribution charges, adjustments and reconciliation adjustments under Rider VBA would be larger than if such fixed costs were instead recovered through fixed customer charges.

Q. Do you agree with Ms. Harden's proposal on pages 10-11 of her direct testimony that, in their next rate cases, North Shore and Peoples Gas adopt uniform numbering of their service classifications?

A. No. The Utilities understand Ms. Harden's concerns but note that such changes may have implications for the Utilities' customer information system. Accordingly, the Utilities are unable to agree to Ms. Harden's proposal until a full assessment of such changes has been completed.

Q. Do you have any general comments about Ms. Harden's rate design proposals?

A. Yes. While I respond to each of her proposals, it is notable that she did not propose specific rates, nor provide any supporting workpapers from which rates or bill impacts could be derived. Consequently, some of her proposals are incomplete. For example, a recommendation about a specific charge does not address the effect of that recommendation on other charges or other customer groups. I explain the possible effects of certain proposals and why their adoption may adversely affect other customers.

A. <u>S.C. No. 1 - North Shore - Staff Testimony</u>

Q. Do you agree with Ms. Harden's recommendation on page 14 of her direct testimony that the percentage of fixed costs recovered through the S.C. No. 1 customer charge remain the same as set in the last rate case?

A. No. North Shore's proposed customer charge is less than the customer related fixed costs underlying the charge and results in a modest increase in fixed cost recovery as well as reasonable bill impacts for customers. Ms. Harden fails to mention that a lower customer charge would result in higher distribution charges as both types of charges would recover the revenue requirement for S.C. No. 1. Ms. Harden also did not propose any specific charges or any analysis which would show the effects of her proposals on North Shore or its customers.

Q. Other than the Account 904 issue, which you address above and which you said Ms. Hoffman Malueg will also address, do you agree with Ms. Harden's testimony concerning the S.C. No. 1 distribution charges?

A. Yes. Other than the Account 904 Cost issue, I agree with Ms. Harden's testimony concerning the percentage amount of North Shore's S.C. No. 1 distribution charge that should be recovered through the front and end blocks of its declining block distribution charge.

B. S.C. No. 1 - Peoples Gas - Staff Testimony

Q. Do you agree with Ms. Harden recommendation on page 38 of her direct testimony that the percentage of fixed costs recovered through the S.C. No. 1 customer charge remain the same as set in the last rate case?

A. No. Peoples Gas' proposed customer charge is less than the customer related fixed costs underlying the charge and results in a modest increase in fixed cost recovery as well as reasonable bill impacts for customers. Ms. Harden fails to mention that a lower customer charge would result in higher distribution charges as both types of charges would recover the revenue requirement for S.C. No. 1. Ms. Harden also did not propose any specific charges or any analysis which would show the effects of her proposals on Peoples Gas or its customers.

Q. Other than the Account 904 Cost issue, which you address above and which you said Ms. Hoffman Malueg will also address, do you agree with Ms. Harden's testimony concerning the S.C. No. 1 distribution charges?

A. Yes. Other than the Account 904 Cost issue, I agree with Ms. Harden's testimony concerning the percentage amount of Peoples Gas' S.C. No. 1 distribution charge that should be recovered through the front and end blocks of its declining block distribution charge.

C. S.C. No. 1 - Peoples Gas and North Shore - AG/CUB/City Testimony

Q. AG/CUB/City witness Mr. Rubin explains, on pages 6-7 of his direct testimony, that he performed certain analyses using data that the Utilities provided. What was the data that the Utilities provided that Mr. Rubin used in his analyses?

A. Peoples Gas provided actual monthly therms billed for about 531,000 customer accounts for the 12-month period ending June 30, 2008. North Shore provided actual monthly therms billed for about 104,000 customer accounts for the same period.

Q. Is it appropriate to use the data as Mr. Rubin did?

A. No. Mr. Rubin used the data inappropriately and selectively to support his tiered rate proposals for the Utilities. Later in my testimony, I describe examples of problems with his use of the Utilities' data.

Q. What is Mr. Rubin's "tiered rates" proposal?"

A. Mr. Rubin describes "tiered rates" as flat monthly charges that are set based on the customer's annual level of consumption. Mr. Rubin proposes seven tiered rates for each utility. Under Mr. Rubin's proposal, a customer's fixed monthly rate would be based upon his consumption in a previous annual period and the tier in which such consumption falls.

Q. Is Mr. Rubin's tiered rate proposal based on sound ratemaking principles or a knowledgeable use of the Utilities' data?

A. No. Rates for a future test year are usually set by using test year billing determinants which have been derived by using extensive modeling, as well as an assumption of normal weather conditions. This is done to develop the most reasonable projections for test year customers and their related usage. Mr. Rubin derives his tiered rate proposals by using neither. Instead, his proposals are based on historical actual data for a subset of the Utilities' customers and a simple mathematical exercise. His methodology is problematic for several reasons.

First, the historical 12-month period ending June 2008, which is the basis for Mr. Rubin's proposal, was 5% colder than normal for the entire year, and 8% colder than normal for the November through March winter period, when residential customers' usage is most weather sensitive. As Mr. Rubin did not normalize customers' usage for the year or the winter period, the usage and volumetric revenues that he used to derive his tiers and his tiered charges are overstated. Accordingly, under normal weather conditions, customers would most likely fall into the lower tiers rather than the tiers assumed by Mr. Rubin, thereby ensuring that the Utilities will not earn their Commission approved revenue requirements.

Second, in addition to not normalizing historical usage, Mr. Rubin did not perform any modeling or analysis to determine how customers' usage would change from a period that spans from mid-2007 through mid-2008, to the 2010 test year. The Utilities' witness Mr. Clabots has shown in his direct testimony that customers' usage has been declining each year for a variety of reasons.

Third, Mr. Rubin assumes that the tiers that he derived by using a sub-set of customers (Mr. Rubin uses the term "bills") could be extrapolated with a simple mathematical calculation (number of bills in each sub-set tier divided by total bills), to determine the number of customers that would fall into each of his proposed tiers for the 2010 test year. For Peoples Gas, there are 770,082 S.C. No. 1 customers in test year 2010. Mr. Rubin uses historical information for 531,106 customers, or 69% of total customers, and simple mathematical calculations, to assign tiers for 238,976 customer accounts, without having any real knowledge of the specific annual usage for this significant number of customers. For North Shore, there are 149,731 S.C. No. 1

customers in test year 2010. Mr. Rubin uses historical information for 103,858 customers, or 69% of total customers, and simple mathematical calculations, to assign tiers for 45,873 customer accounts, without having any real knowledge of the specific annual usage for this significant number of customers.

Fourth, Mr. Rubin's simplistic analysis of the Utilities' raw customer data does not take into account some of the complexities associated with such data. Other than a billing system that is designed to capture and address such complexities, it is virtually impossible to do so with limited or no knowledge of such billing complexities, and using the tools employed by Mr. Rubin. As Mr. Rubin did not understand, recognize or address such complexities, his billing analysis which underlies his tiered rate proposal is flawed. For instance, certain customers in the bottom of each tier show annual usage which is consistent with the annual usage range for the tiers proposed by Mr. Rubin. However, their monthly usage may reflect bi-monthly billing or bill adjustments, and may show zero usage in certain months. Without knowing that, Mr. Rubin inappropriately priced usage related to a prior period at the lower-priced end block charge than the higher-priced front block charge, resulting in present rate bill amounts that are too low for some customers. As the underlying bill amounts that were computed by Mr. Rubin are questionable, his proposed charges are questionable as well.

Fifth, as discussed previously, Mr. Rubin complicates his proposal even further by using a simple mathematical exercise to determine which tier to place nearly 300,000 customers. He justifies this by stating that the Utilities provided only sub-sets of data. However, he does not explain why the sub-sets of data were provided. The Utilities' customers, particularly those for Peoples Gas, are very transient. They move often from one premises to another, establishing new accounts for service. Customers are also disconnected for non-payment, or at their own request. These types of situations result in the creation of new customer accounts and incomplete billing histories. As discussed above, limited or no knowledge of these types of complexities would cause the raw data to be used inappropriately. The Utilities offered the sub-sets of data to provide enough useful data and to avoid any inappropriate use of the additional data that may reflect incomplete billing histories. However, the Utilities did not know how Mr. Rubin would use the data that was provided. Although Mr. Rubin attempts to address the lack of customer data with a mathematical exercise, his efforts result in conceptual and practical problems, which are discussed later in my testimony. If the Utilities had provided data for the additional 300,000 customers, which would have been incomplete and not comparable to the data provided, it is likely those problems would have been compounded.

Last, Mr. Rubin does not explain how he determined the number of tiers or the ranges for each tier. He proposes seven tiers but doesn't explain why seven tiers are appropriate. The first four tiers reflect a span of 500 annual therms. Tiers five and six span 1,500 annual therms and tier seven is for annual usage over 5,000 therms. Mr. Rubin failed to explain why the number of tiers and ranges for each are appropriate.

Q. Is his concept reasonable for the Utilities?

A. Absolutely not. Mr. Rubin does not address how the Utilities would be affected, or whether they would recover their Commission approved revenue requirements if customers fall into tiers other that those that he assumes or assigns in his analyses. As discussed above, his methodology, which establishes his tiered rate proposal, is fraught with problems. In the first year of such a proposal, the Utilities could easily under-recover their Commission approved revenue requirement. NS-PGL Exs. VG-2.1P and VG-2.1N illustrate how Peoples Gas and North Shore, respectively, could under-recover their revenue requirements if customers fall into a lower tier than the tiers assumed by Mr. Rubin. The revenue impact could be significant. With even the smallest error in Mr. Rubin's assumptions, Peoples Gas and North Shore could very well initially under-recover their approved revenue requirements by $14.6 million and $1.7 million, respectively. These amounts, which are illustrative, could be much higher, based on actual experience. Such under-recovery is likely to occur since (1) Mr. Rubin bases his tiers, and customers' positions in such tiers, on higher usage arising from colder than normal weather, and (2) a significant number of customers, whose tiers are assigned based on a sub-set of customers showing higher than normal usage, could fall within any of the seven tiers other than those assigned by Mr. Rubin. These problems would be exacerbated after the initial year as a result of Mr. Rubin's proposal that requires the Utilities to move customers to different tiers based on their actual usage. Curiously, Mr. Rubin claims that tiered rates would obviate the need for Rider VBA or any other type of decoupling. On the contrary, his tiered rate proposals would result in a greater need for Rider VBA or a similar decoupling mechanism as the Utilities would be required to move customers to a tier that may differ from that for which the tiered rate and assumed revenue requirement recovery was based.

Q. Are there any other conceptual issues that you would like to address?

A. Yes. Mr. Rubin indicated that he has been advised of certain provisions related to pending legislation (Senate Bill 1918). This pending legislation includes an energy efficiency component, which requires utilities to achieve certain energy efficiency standards or be subject to penalty. Mr. Rubin does not explain how the Utilities would earn their Commission approved revenue requirements if customers continue to move to lower priced tiers due to their own energy efficiency efforts, the Utilities' current energy efficiency programs, energy efficiency programs that would arise from Senate Bill 1918, as well as from his proposed tiered rate design that would encourage further usage reductions.

Q. In addition to the conceptual issues you identified, are there practical problems with Mr. Rubin's proposal?

A. Yes. First, Mr. Rubin's proposal would result in seven different tiered rates for each Utility under an assumption that neither customer nor distribution charges for sales and transportation customers would be differentiated. However, I have been advised by counsel that pending Senate Bill 1918 allows for a utility to elect to recover *incremental* uncollectible accounts expenses not recovered through a utility's base rates, through a separate rider. As the Utilities are not proposing to strip uncollectible accounts expenses out of base rates, there will be a need for a differentiation in rates, with only incremental differences being recovered or refunded through a rider, assuming the bill becomes law and the Utilities elect to recover such incremental costs through a rider. Consequently, Mr. Rubin's tiered rate proposal would require 14 tiered rates: seven for sales customers and seven for transportation customers. This would result in unnecessarily complicating the S.C. No. 1 tariff, billings to customers, and the Utilities' customer information system to accommodate 14 different charges and 7 different usage levels for small residential customers of each utility.

Second, the Utilities would need to make significant modifications to their customer information system to track the historical usages, apply different tiered rates, and annually evaluate such tiers for nearly one million customers. The magnitude of such modifications could result in significant costs, which are not currently reflected in the Utilities' test year costs.

Third, Mr. Rubin oversimplifies the exercise of placing customers in tiers as an initial matter (e.g., a customer with less than 12 months' usage, a customer with gas theft, a customer with many estimated readings because the customer does not permit access to the meter, etc.), as well as the treatment of new customers. As discussed earlier in my testimony, these are complex rather than simple situations.

Fourth, the Utilities would need to develop and implement extensive customer and employee communications programs and roll them out each year to educate customers who may be moved to a different tier. Mr. Rubin does not address the need for or the extent of the efforts and costs that would be related to such activities. Such costs are also not reflected in the Utilities' test year costs.

Fifth, Mr. Rubin does not address a dispute resolution procedure for customers who, for example, contest their placement in a tier or movement to a higher tier or billing adjustments that show the customer should have been in a tier other than the one used for billing or billing adjustments and disputes that span two periods for purposes of tier determination.

Sixth, Mr. Rubin's proposal does not consider the effects of disconnections on the Utilities. Mr. Rubin's tiered rate proposal would place the Utilities in a catch-22 situation where they are penalized by disconnecting customers at the customers' request or for non-payment. Many disconnected customers would be reconnected at a lower charge, not because they are more efficient energy users (which is the rationale underlying Mr. Rubin's tiered rate proposal) but because of disconnection of service arising from voluntary disconnections or non-payment of their utility bills. In essence, Mr. Rubin's tiered rate proposal would reward customers for non-payment of bills, or voluntary disconnections, or moving the account name from one resident to another at the same premises, to create incomplete bill histories as they would and could, result in potential gaming by customers.

Seventh, Mr. Rubin does not consider the complexities that would arise for sales revenue forecasting. Not only would the Utilities need to forecast their overall sales level, they would need to determine into which of the seven tiers the usage levels would fall for sales customers, and then again for transportation customers, which would result in a need to forecast 14 tiers of revenues for each utility, for a single service classification, S.C. No. 1. If the prior year was colder or warmer than normal, the Utilities would also need to determine how to normalize the usage for each of the 14 tiers to derive a reasonable forecast of its revenues.

Q. Do Mr. Rubin's implementation proposals on pages 38-40 of his direct testimony address the practical issues you identified?

A. No. At most, he poses possible solutions for a few situations.

Q. Are Mr. Rubin's analogies to how customers pay for services like telecommunications, Internet and cable television (page 29 of his direct testimony) similar to his proposals?

A. No. Mr. Rubin even acknowledges that tiered rates have not been used in energy services. For the industries he identified, customers are able or required to choose the level of services that they desire, such as minutes, unlimited service, number of channels, premium channels, etc. Such elections are usually made in advance, before the customer uses the service. Generally, if customers use more than their elected service, they are billed additional charges on each unit of additional service rather than automatically moved by the service provider to a higher priced plan. I am not aware of any service provider that automatically switches customers to a lower priced plan if their actual usage declines below what the customer elected. Other than the fact that these industries offer tiered rates, there is little similarity between the pricing practices of these industries and Mr. Rubin's proposal. To support his proposals, Mr. Rubin focuses on the value of the service to the customer rather than the cost to provide service to the customer. The Utilities' customers do not elect the level of gas distribution service that they desire in advance. They consume what they need or desire. Also, other than unfounded theory, Mr. Rubin has not provided any evidence that a customer who uses 5,000 annual therms values gas service any more than the customer who uses 1,000 annual therms.

Q. Do you agree with what Mr. Rubin considers to be benefits of the tiered rates he developed as he explains on pages 36-37 of his direct testimony?

A. No. The benefits identified by Mr. Rubin, for the most part, are biased toward the customer and do not recognize any potential detriment to the Utilities. Others are misleading or untrue. Specifically:

- Mr. Rubin states that tiered rates would encourage customers to conserve and use less gas. He also claims that tiered rates would obviate the need for Rider VBA or any other type of decoupling. However, these two situations cannot co-exist.

If tiered rates encourage customers to conserve, they would move to lower priced tiers, which would cause the Utilities' revenues to decline below that approved by the Commission. Consequently, there is an even greater need for a decoupling mechanism such as Rider VBA.

- Mr. Rubin claims that tiered rates would simplify the rate case process because the Utilities would no longer need to project or normalize sales. He further states that the Commission would only need to determine the number of customers in each tier. It is not clear how the Utilities or the Commission would determine under what tier the customers would fall without knowing their annual usage. As stated previously in my testimony, if the prior period was colder or warmer than normal it would affect customers' movements among the tiers. Are the Utilities and the Commission to presume that weather in the subsequent period will be consistent with that in the prior period, with customers remaining in the same tiers? I would think not as this would be inconsistent with the established practice of using normal sales volumes to establish rates.

- Mr. Rubin claims that it would no longer be necessary to project the number of transportation customers and their usage. However, the Utilities would still need to determine the number of transportation customers and their usage for gas supply planning purposes. Tiered rates would not obviate that activity. Also, as explained earlier, rates would need to be differentiated for sales and transportation due to uncollectible accounts expenses that would still be included in base rates.

- Mr. Rubin claims that tiered rates would avoid what he considers the very severe impacts of straight fixed variable ("SFV") rates on low-use customers and the very large rate reductions that can be received by high-use customers. As explained below, his tiered rate proposals result in large increases for customers at the low end of each tier and relatively small increases or significant decreases for customers at the high end of each tier.

- Mr. Rubin claims that tiered rates recognize the effects of diversity and require those who use more gas to pay higher rates. That may be true for each tier. However, it may not be true within each tier. Mr. Rubin moves customers in the low and high end of the tier towards the median. This results in significant increases for customers at the low end of the tier; scattered increases around, but not at the class average, for those near the median of the tier; and very small increases or even significant decreases for those at the high end of the tier. Tables 1 and 2 below are summaries of the bill increases and decreases that would result from Mr. Rubin's proposals. NS-PGL Ex. VG-2.2 shows, using Mr. Rubin's own data, how these bill impacts were derived.

Table 1 - AG/CUB/City Witness Rubin Tiered Rate Proposal
Annual Bill Impact on Peoples Gas Customers

Tiers (Therms)	Increase/Decrease Low	Median	High
0 - 500	67%	42%	-12%
500 - 1,000	79%	29%	9%
1,000 - 1,500	77%	30%	15%
1,500 - 2,000	72%	30%	17%
2,000 - 3,500	71%	32%	6%
3,500 - 5,000	66%	31%	11%
More than 5,000	74%	36%	-37%

Table 2 - AG/CUB/City Witness Rubin Tiered Rate Proposal
Annual Bill Impact on North Shore Gas Customers

Tiers (Therms)	Increase/Decrease Low	Median	High
0 - 500	81%	25%	5%
500 - 1,000	59%	29%	14%
1,000 - 1,500	56%	30%	17%
1,500 - 2,000	57%	31%	19%
2,000 - 3,500	51%	32%	10%
3,500 - 5,000	49%	31%	17%
More than 5,000	69%	44%	-65%

Q. Aside from your conceptual and practical concerns about Mr. Rubin's proposal, do you have any comments on the data he presents in support of his conclusions?

A. Yes. Mr. Rubin frames the reasonableness of his tiered rate proposal by characterizing, on pages 6 through 11 of his direct testimony, the Utilities' present and proposed rate designs as being unfair to customers who use gas more efficiently, and more favorable to customers who use gas less efficiently. He does so by analyzing historical bills for approximately 15,000 and 4,000 customers for Peoples Gas and North Shore, respectively. According to Mr. Rubin these customers' annual usage was close to the median usage level from the subsets of customers that I discussed earlier in my testimony. However, Mr. Rubin cherry picks data from these customers' bills to support his criticism of the Utilities' declining block distribution rates.

Q. How does Mr. Rubin selectively uses Peoples Gas' billing data to criticize its declining block distribution rates?

A. The billing data for the 15,752 Peoples Gas customers Mr. Rubin analyzed include customers whose annual historical usage ranged between 1,050 and 1,100 therms. Mr. Rubin states that under Peoples Gas' present rates, the annual bills for these customers should not vary by more than $17.00 per year. He determined this amount by taking Peoples Gas' present rate front block distribution (which rounded, is 34 cents) and multiplying it times 50 therms (1,100 – 1,050 therms). Mr. Rubin then states that under Peoples Gas' present rates, the annual bills for this group of customers ranged from $332 to $440, a difference of $108.00, rather than the $17 which he expected. To support his statement, Mr. Rubin provided the annual bills for the lowest usage customer and the highest usage customer of the approximately 15,000 customers he analyzed. However, these two customers are more the exceptions than the rule. To set rates for his tiered rate proposals, Mr. Rubin started with the average annual bill in each of his proposed tiers to develop rates for each tier. However when analyzing Peoples Gas' present and proposed rates, he ignores both the average and median bills and instead compares two annual customer bills from the tails of the 15,752 customers to support his criticism of Peoples Gas' rates. Under present rates, the annual median and average bills for these 15,752 Peoples Gas customers are about $406. About 94% of the annual customer bills under present rates fall within $17 of the median. Under proposed rates, the annual median and average bills for the 15,752 Peoples Gas customers are about $554, with about 95% of those customers' annual bills falling within $20 of the median. Using Mr. Rubin's logic about the expected range of these customers' annual bills, I calculated the $20 by taking Peoples Gas' proposed front block distribution rate (39.861 cents) and multiplying it times 50 therms. As well over 90% of the annual bills for these customers are within the annual median and the average bills under both present and proposed rates, it proves that contrary to Mr. Rubin's characterization of the bill impacts that would result from Peoples Gas' proposed rates, the Utility's proposed rate structures are sound, reasonable and consistent with its stated objectives.

Q. Does Mr. Rubin make any other selective use of Peoples Gas' billing data to criticize the Utility's declining block distribution rates?

A. Yes. Mr. Rubin derived annual bill impacts for two customers, Customer A and Customer B, who have nearly the same annual usage, but different load factors. Using monthly data, Mr. Rubin derived load factors of 56% and 32%, respectively for each of these customers. Using this data, Mr. Rubin concluded that under Peoples Gas' present and proposed rates, the less efficient customer (Customer B) is billed a lesser amount than the more efficient customer (Customer A). However, Mr. Rubin did not mention that these two customers are not typical of the customers that he analyzed. In fact, of the 15,752 bills that Mr. Rubin analyzed, only 1.9% represent customers whose load factors are less than or equal to 32%, and only 0.5% represent customers whose load factors are 56% or greater. Once again, the information selected by Mr. Rubin represents more the exceptions than the rule. The load factors for 15,368 customers, or about 98%, are between the two tail customers selected by Mr. Rubin. As stated previously, under

Peoples Gas' present and proposed rates, the annual bills for well over 90% of these customers are consistent with the median and average annual bills for the entire group.

Q. Please discuss how Mr. Rubin selectively uses North Shore's billing data to criticize its declining block distribution rates.

A. The billing data for the 4,094 North Shore customers include customers whose annual historical usage ranged between 1,200 and 1,250 therms. Mr. Rubin stated that under North Shore's present rates, the annual bills for these customers should not vary by more than $12.00 per year. He determined this amount by taking North Shore's present rate front block distribution (which rounded, is 24 cents) and multiplying it times 50 therms (1,250 – 1,200 therms). Mr. Rubin then states that under North Shore's present rates, the annual bills for this group of customers ranged from $297 to $346, a difference of almost $50.00, rather than the $12 which he expected. To support his statement, Mr. Rubin provided the annual bills for the lowest usage customer and the highest usage customer of the approximately 4,000 customers he analyzed. However, as with his Peoples Gas analysis, these two customers are more the exceptions than the rule. To set rates for his tiered rate proposals, Mr. Rubin started with the average annual bill in each of his proposed tiers to develop rates for each tier. When analyzing North Shore's present and proposed rates, he again ignores both the average and median bills and instead compares two annual customer bills from the tails of the customers to support his criticism of North Shore's rates. Under present rates, the annual median and average bills for these 4,094 North Shore's customers are about $325. About 95% of the annual customer bills under present rates fall within $12 of the median. Under proposed rates, the annual median and average bills for the customers are about $442, with about 95% of those bills falling within $15 of the median. Using Mr. Rubin's logic about the expected range of these customers' annual bills, I calculated the $15 by taking North Shore's proposed front block distribution rate (29.260 cents) and multiplying it times 50 therms. As well over 90% of the annual bills for these 4,094 customers are within the annual median and the average bills under both present and proposed rates, it proves that contrary to Mr. Rubin's characterization of the bill impacts that would result from North Shore's proposed rates, the Utility's proposed rate structures are sound, reasonable and consistent with its stated objectives. Mr. Rubin does not make a Customer A and B comparison for North Shore.

Q. What is Mr. Rubin's "demand-based rates" proposal (pages 14-16 of his direct testimony), which he did not recommend that the Commission adopt, but he stated that the demand-based rates are preferable to the Utilities' proposals (page 18 of his direct testimony)?

A. Mr. Rubin derives his demand-based distribution rates by recovering all remaining customer costs through the front block, and all demand and commodity related costs (or variable distribution costs as he states) on a per therm basis to both the front and end block of Peoples Gas' declining two-block rate structure.

Q. Do you think this concept is reasonable to apply to the Utilities?

A. This concept is more reasonable and theoretically sound than Mr. Rubin's tiered rates proposals. However, the resulting rates from this concept would result in adverse impacts for the Utilities and their customers.

Q. Are there any practical obstacles to adopting this type of rate?

A. Although the distribution rates arising from Mr. Rubin's demand-based proposals are somewhat similar to those proposed by the Utilities and would result in similar bill impacts for certain customers, Mr. Rubin's proposals push more of the Utilities' revenues toward the end block, the block which is most affected by weather variations. As a result, there is a greater need for a decoupling mechanism, such as Rider VBA, with this type of rate.

Q. Aside from the concerns you described above, are there any errors in the rates Mr. Rubin presented?

A. Yes. Mr. Rubin assumed that charges would not be differentiated among sales and transportation customers and did not factor in revenues or credits arising from the Utilities' transportation program when developing his rates. I explained previously why the rates for sales and transportation customers would need to continue to be differentiated. Table 3 provides a comparison of Peoples Gas' proposed rates, Mr. Rubin's demand-based rate proposal, and Mr. Rubin's demand-based rates proposal corrected for the items discussed above. Included is a comparison of the percentage of revenue that would be recovered through each block, which supports my statements regarding the shift in revenue recovery and the greater need for a decoupling mechanism such as Rider VBA. Table 4 provides the same information for North Shore. As shown in Table 3, Mr. Rubin's corrected demand-based rates proposal for Peoples Gas would result in 40% being recovered in the more weather sensitive end block rather than the 35% proposed by Peoples Gas and supported by Staff witness Ms. Harden. As shown in Table 4, Mr. Rubin's corrected demand-based rates proposal for North Shore would result in 44% being recovered in the more weather sensitive end block rather than the 33% proposed by Peoples Gas and supported by Staff witness Ms. Harden.

Table 3 - Comparison of Peoples Gas and AG/CUB/City Witness Demand-Based Rates Proposals - S.C. No. 1

	Peoples Gas Proposal		AG/CUB/City Witness Original Proposal	AG/CUB/City Witness Corrected Proposal	
	Charge	% of Distribution Revenue	Charge	Charge	% of Distribution Revenue
Customer Charge					
Sales	$ 23.30		$ 23.30	$ 23.30	
Transportation	$ 20.50		$ 23.30	$ 20.50	
Distribution Charge					
1st 50 Therms	39.871 ¢	65%	35.954 ¢	36.949 ¢	60%
Over 50 Therms	14.766 ¢	35%	16.787 ¢	16.776 ¢	40%

Table 4 - Comparison of North Shore and AG/CUB/City Witness Demand-Based Rates Proposals - S.C. No. 1

	North Shore Proposal		AG/CUB/City Witness Original Proposal	AG/CUB/City Witness Corrected Proposal	
	Charge	% of Distribution Revenue	Charge	Charge	% of Distribution Revenue
Customer Charge					
Sales	$ 19.90		$ 19.90	$ 19.90	
Transportation	$ 19.00		$ 19.90	$ 19.00	
Distribution Charge					
1st 50 Therms	29.260 ¢	67%	24.221 ¢	24.379 ¢	56%
Over 50 Therms	8.224 ¢	33%	11.012 ¢	11.010 ¢	44%

Mr. Rubin's demand-based rates proposals would not only result in increased revenue recovery in the more weather sensitive end blocks and cause a greater need for a decoupling mechanism such as Rider VBA, it would also adversely impact higher usage customers. Table 5, shown below, provides comparisons of the high, low and mean annual bill impacts that would arise from the Utilities' proposals and Mr. Rubin's corrected demand-based rates proposal. For comparative purposes, I used the colder than normal usage data for the 531,106 Peoples Gas customers and 103,858 North Shore customers which underlie Mr. Rubin's tiered rate proposals. For Peoples Gas, the low annual bill increase would be the same, about $60 under Peoples Gas' and Mr. Rubin's proposals. The mean annual bill increase would be similar, with Mr. Rubin's proposal resulting in a $149 annual bill increase compared to $148 arising from Peoples Gas' proposal. However, the high annual bill increase under Mr. Rubin's demand-based rates proposal would be $1,886 compared to $1,495 under Peoples Gas' proposal, or about 26% higher. For North Shore, the low annual bill increase would be similar, at about $66 under Mr. Rubin's proposal and $68 under North Shore's proposal. The mean annual bill increase would be similar, with Mr. Rubin's proposal resulting in a $123 annual bill increase compared to $120 arising from North Shore's proposal. However, the high annual bill increase under Mr. Rubin's demand-based rates proposal would be $1,862 compared to $825 under North Shore's proposal, or 126% higher.

Table 5 - Annual Bill Change Comparison
Under Utilities' Proposed Rates and AG/CUB/City Witness Rubin Demand-Based Rates

	Peoples Gas		North Shore Gas	
	Utility Proposal	Mr. Rubin Proposal	Utility Proposal	Mr. Rubin Proposal
Low	$ 60	$ 60	$ 68	$ 66
Mean	$ 148	$ 149	$ 120	$ 123
High	$ 1,495	$ 1,886	$ 825	$ 1,862

Q. How do you respond to Mr. Rubin's statement on page 6 of his direct testimony that there is no cost basis for the S.C. No. 1 "steeply declining" blocks that the Utilities proposed for the distribution charge?

A. Mr. Rubin's argument is grounded in his reasoning that there is only one acceptable methodology for recovering demand related costs. As discussed below, there are several acceptable methods for recovering such costs.

Q. Mr. Rubin states, on page 12 of his direct testimony, that it is not reasonable to include demand-related costs in the customer charge. Did the Utilities include demand-related costs in the customer charge?

A. No, the Utilities did not include any demand-related costs in its proposed customer charges for S.C. No. 1. However, it is reasonable to include such costs in a flat monthly charge such as the customer charge for the reasons discussed in my direct testimony for Peoples Gas and North Shore (Peoples Gas Ex. VG-1.0, 14-15:310-319 and on North Shore Ex. VG-1.0, 13:275-284) and for the reasons discussed below.

Q. Do Mr. Rubin's demand-based rates that you discussed above address these issues?

A. Not completely. I agree with Mr. Rubin that remaining customer costs should be recovered through the front block. However, Mr. Rubin and I differ on how demand-related costs should be recovered. Mr. Rubin proposes to recover all demand-related costs on an equal cents per therm basis for both the first and second blocks. This infers that demand-related costs are volumetrically based, which they are not. The Utilities proposed an average and peak methodology to allocate demand-related costs in their embedded cost of service studies, under which most costs are allocated to each rate class based on peak day usage and a lesser amount is allocated based on average usage. The resulting rate design should consider how underlying costs are reflected in the Utilities' supporting cost studies. However, there is often disagreement on how to allocate demand-related costs. In fact, the Gas Distribution Rate Design Manual Prepared by the

National Association of Regulatory Utility Commissioners ("NARUC") Staff Subcommittee on Gas (June 1989) states on pages 49-50:

> "The most controversial issue is deciding where capacity costs belong in the rate. Because they are fixed costs, it is sometimes argued that they should be part of the customer charge. On the other hand, it can be argued that … those common fixed costs should be recovered evenly from all units of commodity sold. It is even occasionally proposed that these costs be spread between customer and commodity charges."

This passage confirms that demand-related costs are fixed, and that there are a few acceptable methodologies for recovering such costs. The Utilities believe that absent a fixed demand charge, such fixed costs should be recovered through a fixed charge such as the customer charge, or spread between the customer and commodity charges. This is not unreasonable as argued by Mr. Rubin. Such cost recovery methods represent two of the three ideological methods discussed in the NARUC manual. On the other hand, Mr. Rubin believes that one of the three, recovery evenly from all units of commodity sold, is the only reasonable recovery method.

Q. Mr. Rubin states that he was advised by counsel that there is a bill passed by the Illinois legislature that would allow utilities to recover uncollectible expenses through a separate rider. Do you agree with his conclusion on pages 15-16 of his direct testimony that such a rider would make it unnecessary to have different base rates for sales and transportation customers?

A. No. The basis of my disagreement is discussed previously in my testimony.

Q. Mr. Rubin states, on pages 21-22 of his direct testimony, that there are problems with SFV rates. Would SFV rates be reasonable for the Utilities' S.C. No. 1?

A. Yes, SFV would be a reasonable alternative for the Utilities' S.C. No. 1. Unlike Mr. Rubin's tiered or demand-based rate proposals, SFV rates would obviate the need for a revenue decoupling mechanism as such rates would not be usage based. As discussed earlier in my testimony, Mr. Rubin's tiered rate and demand-based rates proposals would result in an even greater need for a decoupling mechanism, as both are usage based. Mr. Rubin's proposed tiered rates would both encourage and require movement to a lower priced tier based on reduced usage. Mr. Rubin's proposed demand based rates would increase charges for the end block, where usage is most sensitive to weather. On the other hand, SFV rates would not only stabilize the Utilities' base rate delivery revenues, it would also provide benefits to the customer by providing a stable, unchanging rate.

Q. On page 25 of his direct testimony, Mr. Rubin states that SFV provides no additional incentive (beyond the gas cost) to conserve energy. Is that a flaw with SFV rates?

A. No, it is not a flaw with SFV rates. The Commission appears to agree. In fact, the Commission, in its final order in the Northern Illinois Gas Company rate case, Docket No. 08-0363, stated:

> "The Commission is not convinced that an SFV rate design reduces the incentive to conserve natural gas. These costs are in fact fixed costs, cannot be conserved, and result in an under-recovery of fixed costs for the utility during periods of milder than average weather and an over-recovery of fixed costs for the utility during periods of colder than average weather. We conclude there is no disincentive a consumer may have by a move toward recovering fixed costs through fixed charges, as opposed to recovery on a volumetric basis. We further conclude that a Rate 1 design that more accurately reflects a consumer's actual costs does not impede conservation."

Q. Mr. Rubin, on pages 26-27 of his direct testimony, states that Rider VBA is a problem because it does not recognize new revenues from added customers. Is that a flaw with Rider VBA?

A. No. Rider VBA is a symmetrical mechanism, which doesn't recognize revenues from new customers or revenue losses from customer reductions. It is appropriate not to recognize new customers because the Utilities incur costs to add customers to their systems. These costs include the addition of new services and meters as well as other expenses to serve new customers joining the system. Rider VBA allows the Utilities to recover, rather than inappropriately refund, their costs for connecting new customers. Moreover, Rider VBA also prevents the Utilities from recovering revenues for load losses associated with customers leaving their systems.

Q. Mr. Rubin states, on page 19 of his direct testimony, that there are several important rate design principles that should be considered, including "gradualism, equity and rate continuity." Do you agree that these three principles are important?

A. Yes. In fact, these principals are three of the guiding seven objectives that I have identified in my direct testimony for developing the rate designs proposed by the Utilities (Peoples Gas Ex. VG-1.0, 5-6, 110:116 and North Shore Ex. VG-1.0, 6, 109:115).

Q. Are your rate design proposals consistent with these principles?

A. Yes.

Q. What other key principles are met by your proposals?

A. My proposals would also recover the Utilities' revenue requirements, better align revenues with underlying costs, send the proper price signal and provide more equity within and between rate classes.

Q. Is Mr. Rubin's tiered rate proposal consistent with these principles?

A. Not completely. Mr. Rubin's proposal arises from a fairly narrow focus on the principal of "conservation of resources" rather than those of gradualism, equity and rate continuity. While the Utilities believe that this is a valid focus, it must be balanced with the other principals or objectives, such as the seven objectives discussed in my direct testimony. As Tables 1 and 2 of my rebuttal testimony illustrate, Mr. Rubin's proposal would result in significant, rather than gradual or equitable, billing impacts for customers near the bottom and top of each tier. As far as rate continuity, Mr. Rubin proposes a flat monthly but usage based charge, which differs from the Utilities' current rate designs, and could change annually based on usage, rather than remain stable like a flat monthly SFV charge. Mr. Rubin's proposal in conjunction with his recommendation to eliminate Rider VBA also conflicts with the Utilities' objective to recover their revenue requirements as it would encourage reduced usage and eliminate the mechanism which allows the Utilities to mitigate the revenue impact of such reduced usage.

D. S.C. No. 2 - North Shore - Staff Testimony

Q. As with her S.C. No. 1 proposals, Ms. Harden disagrees that the percentage of fixed costs recovered through the customer charge should increase (page 22). Please comment.

A. Under North Shore's proposals for S.C. No. 2, about 54% of the revenue requirement for S.C. No. 2 will be recovered through fixed charges. This represents a modest amount of fixed cost recovery, and is well below the 80% fixed cost recovery allowed for other

Illinois gas utilities for their general service rate classes. North Shore's proposals also result in reasonable bill impacts for customers. Ms. Harden fails to mention that lower customer charges would result in higher distribution charges as both types of charges would recover the revenue requirement for S.C. No. 2. Also, North Shore's proposed S.C. No. 2 includes three customer charges for three different meter classes. Ms. Harden does not specify which customer charges should be reduced nor the effects of such reductions on customers in each meter class.

Q. Beginning on page 17 of her direct testimony, Ms. Harden discusses North Shore's proposal to add Meter Class 3 to S.C. No. 2. She recommends adding Meter Class 3 (page 20) but believes the revenue requirement should be distributed "more evenly" over customers (pages 21-24). Do you agree with Ms. Harden that the bill impact of North Shore's proposed Meter Class 3 is a problem?

A. No. Ms. Harden states that my direct testimony does not discuss any of the bill impacts on the S.C. No. 2 customers that would be reclassified as Meter Class 3. However page 23 of my direct testimony addresses bill impacts and provides a reference to North Shore Ex. VG-1.8 (a duplicate of North Shore's Schedule E-9), which shows bill impacts arising from all of North Shore's rate proposals, including those customers who would be reclassified as Meter Class 3. This meter class includes those customers with the largest usage among the three meter classes. However, Ms. Harden narrowly focuses on a potential monthly increase for sales customers in this meter class, assuming zero monthly usage, which is not typical, rather than the increase which would arise from a more typical usage level. For example, the increase of 210.0% cited by Ms. Harden arises from a monthly increase of $129.10 if there is zero usage, a non-typical situation.

However, assuming monthly usage of 3,000 therms, which is more typical for this meter class, there would be an increase of $120.89, or 3%, which is also shown on North Shore Ex. VG-1.8, page 4 of 10 and in Schedule E-9. Ms. Harden also does not address the annual bill impacts arising from North Shore's proposals, which were provided in North Shore's response to Staff data request CLH 1.01. An excerpt from this response, attached as NS-PGL Ex. VG-2.3N, shows that under various frequency levels, a more typical increase for S.C. No. 2, Meter Class 3 sales customers would range from 2.95% to 10.53%.

Q. Do you agree with Ms. Harden's claim on page 24 of her direct testimony that North Shore's proposals produce percentage increases that would result in rate shock for Meter Class 3 customers?

A. No. As discussed above, Meter Class 3 includes customers with the largest usage but Ms. Harden focuses the percentage increase that would arise if there is zero usage. In addition, she does not consider how the dollar increase for such a month would compare with months for which there is usage. NS-PGL Ex. VG-2.4 provides billing information from data which supports North Shore's response to Staff data request CLH 1.01. The exhibit shows that the increases from North Shore's proposals for Meter Class 3 would not result in rate shock for a customer with zero usage, or usage below its monthly average usage, as the dollar increases would be consistent with or less than that billed to the customer in other months. For example, June shows an increase of $122.77 or 6.92%, while August shows an increase of $129.60, or 195.77%. The latter percentage, similar to that cited by Ms. Harden, is misleading. The annual bill increase is much lower at

4.52%. These monthly increases, which are similar, as well as the annual increase, which is fairly low, would not result in the rate shock claimed by Ms. Harden.

Q. Do you agree that it would be reasonable to spread the S.C. No. 2 revenue requirement more evenly across the class?

A. No. As mentioned above, Meter Class 3 represents the largest usage customers for S.C. No. 2. As shown on North Shore Ex. VG-1.7 of my direct testimony, North Shore is proposing to recover a lesser amount of fixed costs for Meter Class 3 through the customer charge than for Meter Classes 1 and 2, the small and medium usage meter classes. Spreading the increase more evenly over the rate class would result in larger increases for the smaller usage meter classes and continue the intra-class subsidies that North Shore is attempting to mitigate with its proposals. I note that Ms. Harden provides no specific recommendations or illustrations on how to evenly spread the increase, nor addresses the billing impact that such spreading would have on all three meter classes.

Q. Ms. Harden states, on pages 21 and 24 of her direct testimony, that North Shore should provide information about how to spread the revenue requirement more evenly. If the Commission agrees with Ms. Harden, what is a reasonable alternative to your proposal in direct testimony?

A. North Shore believes that it has demonstrated that its proposals consider the appropriate spreading of costs across the three meter classes. However, if the Commission agrees that a different spreading is necessary, North Shore proposes that the spreading is such that it does not result in an end block distribution charge that is more than 2 cents less than the charge for the middle block of North Shore's three-block distribution charge. This would mitigate the impact of any spreading on smaller usage customers.

E. S.C. No. 2 - Peoples Gas - Staff Testimony

Q. As with her S.C. No. 1 proposals, Ms. Harden disagrees that the percentage of fixed costs recovered through the customer charge should increase (page 45). Please comment.

A. Under Peoples Gas' proposals for S.C. No. 2, only 35% of the revenue requirement for S.C. No. 2 will be recovered through fixed charges. This represents a modest amount of fixed cost recovery and is well below both the 50% fixed cost recovery that the Commission approved for Peoples Gas in Docket No. 95-0032 and significantly below the 80% allowed for other Illinois gas utilities for their general service rate classes. Peoples Gas' proposals also result in reasonable bill impacts for customers. Ms. Harden fails to mention that lower customer charges would result in higher distribution charges as both types of charges would recover the revenue requirement for S.C. No. 2. Also, Peoples Gas' proposed S.C. No. 2 includes three customer charges for three different meter classes. Ms. Harden does not specify which customer charges be reduced nor the effects of such reductions on customers in each meter class.

Q. Beginning on page 40 of her direct testimony, Ms. Harden discusses Peoples Gas' proposal to add Meter Class 3 to S.C. No. 2. She recommends adding Meter Class 3 (page 44) but believes the revenue requirement should be distributed "more evenly" over customers (pages 44-48). Do you agree with Ms. Harden that the bill impact of Peoples Gas' proposed Meter Class 3 is a problem?

A. No. Ms. Harden states that my direct testimony does not discuss any of the bill impacts on the S.C. No. 2 customers that would be reclassified as Meter Class 3. However, page 25 of my direct testimony addresses bill impacts and provides a reference to Peoples Gas Ex. VG-1.8 (a duplicate of Peoples Gas' Schedule E-9), which shows bill impacts arising from all of Peoples Gas' rate proposals, including those customers who would be reclassified as Meter Class 3. This meter class includes those customers with the largest usage among the three meter classes. However, Ms. Harden narrowly focuses on a potential monthly increase for sales customers in this meter class, assuming zero monthly usage, which is not typical, rather than the increase which would arise from a more typical usage level. For example, the increase of 239.6% cited by Ms. Harden arises from a monthly increase of $149.20 if there is zero usage, a non-typical situation. However, assuming monthly usage of 3,000 therms, which is more typical for this meter class, there would be an increase of $189.96, or 4.7%, which is also shown on Peoples Gas Ex. VG-1.8, page 4 of 11 and Schedule E-9. Ms. Harden also does not address the annual bill impacts arising from Peoples Gas' proposals, which were provided in Peoples Gas' response to Staff data request CLH 1.01. An excerpt from this response, attached as NS-PGL Ex. VG-2.3P, shows that under various frequency levels, a more typical annual increase for S.C. No. 2, Meter Class 3 sales customers would range from 4.09% to 9.2%.

Q. Do you agree with Ms. Harden's claim on page 48 of her direct testimony that Peoples Gas' proposals produces percentage increases that would result in rate shock for Meter Class 3 customers?

A. No. As discussed above, Meter Class 3 includes customers with the largest usage but Ms. Harden focuses on the percentage increase that would arise if there is zero usage. In addition, she does not consider how the dollar increase for such a month would compare with months for which there is usage. NS-PGL Ex. VG-2.4 provides billing information from data which supports Peoples Gas' response to Staff data request CLH 1.01. The exhibit shows that the increases from Peoples Gas' proposals for Meter Class 3 would not result in rate shock for a customer with zero usage or usage below the monthly average usage as the dollar increases would be consistent with or less than that billed to the customer in other months. For example, May shows an increase of $169.89 or 7.90%, while August shows an increase of $149.22, or 206.65%. The latter percentage, similar to that cited by Ms. Harden, is misleading. The annual increase is much lower at 4.09%. These monthly increases, which are similar, as well as the annual increase, which is fairly low, would not result in the rate shock claimed by Ms. Harden.

Q. Do you agree that it would be reasonable to spread the S.C. No. 2 revenue requirement more evenly across the class?

A. No. As mentioned above, Meter Class 3 represents the largest usage customers for S.C. No. 2. As shown on Peoples Gas Ex. VG-1.7 of my direct testimony, Peoples Gas is proposing to recover a lesser amount of fixed costs for Meter Class 3 through the customer charge than for Meter Classes 1 and 2, the small and medium usage meter classes. Spreading the increase more evenly over the rate class would result in larger increases for the smaller usage meter classes and continue the intra-class subsidies that Peoples Gas is attempting to mitigate with its proposals. I note that Ms. Harden provides no specific recommendations or illustrations on how to evenly spread the increase, nor addresses the billing impact that such spreading would have on all three meter classes.

Q. Ms. Harden states, on pages 44 and 48 of her direct testimony, that Peoples Gas should provide information about how to spread the revenue requirement more evenly. If the Commission agrees with Ms. Harden, what is a reasonable alternative to your proposal in direct testimony?

A. Peoples Gas believes that it has demonstrated that its proposals consider the appropriate spreading of costs across the three meter classes. However, if the Commission agrees that a different spreading is necessary, Peoples Gas proposes that the spreading is such that it does not result in an end block distribution charge that is more than 3 cents less than the charge for the middle block of Peoples Gas' three-block distribution charge. This would mitigate the impact of any spreading on smaller usage customers.

F. S. C. Nos. 2 and 3 - North Shore - Staff Testimony and
S. C. Nos. 2 and 4 - Peoples Gas - Staff Testimony

Q. Staff witness Mr. Sackett states, on page 13 of his direct testimony, that the Utilities need to provide further justification for enacting what he calls a barrier between S.C. Nos. 2 and 3 (North Shore) and S.C. Nos. 2 and 4 (Peoples Gas). Please describe the "barrier" to which Mr. Sackett refers.

A. The "barrier" described by Mr. Sackett is a current minimum usage requirement of 41,000 average monthly therms for Peoples Gas' S.C. No. 4 that was approved by the Commission in prior rate cases. Peoples Gas proposes to implement an identical maximum usage eligibility requirement for S.C. No. 2. North Shore also proposes to implement 41,000 average monthly therm maximum and minimum eligibility requirements for S.C. Nos. 2 and 3, respectively.

Q. Do any of the Utilities' other service classifications have eligibility requirements?

A. Yes. Peoples Gas' S.C. Nos. 1, 4, 5, 6, 7 and 8 currently have eligibility requirements. North Shore's S.C. Nos. 1, 4, 5 and 6 also currently have eligibility requirements.

Q. In general, why is it reasonable to set eligibility requirements for service classifications?

A. It is reasonable to set eligibility requirements for service classifications because they help to ensure that customers with similar characteristics and costs are grouped and remain together, thereby allowing the Utilities to continue to develop the appropriate costs, rate designs, and service options. This also helps to ensure that customers with dissimilar characteristics, or customers whose characteristics and costs were not reflected in the costs to develop rates and service options, do not migrate to the rate class and rider of their choice for personal benefit, but at the expense of other customers and the Utilities.

Q. How would the lack of eligibility requirements affect the Utilities and customers?

A. The lack of eligibility requirements would allow customers to receive service under a rate class of their choice rather than the rate class underlying their cost of service. This would affect the Utilities' ability to earn their approved revenue requirements as well as potentially cause customers to pay for costs caused by customers who have migrated.

Q. Does Peoples Gas' current S.C. No. 4 include a usage requirement?

A. Yes. The usage requirement for Peoples Gas' S.C. No. 4 was originally approved by the Commission for S.C. No. 3, Large Volume Service, in Docket No. 95-0032. It was approved more recently by the Commission in Docket Nos. 07-0241/07-0242 (cons.), when the Commission allowed Peoples Gas to combine S.C. No. 3, Large Volume Service with S.C. No. 4, Large Volume Demand Service.

Q. Why is it appropriate for Peoples Gas to retain its existing minimum 41,000 therm average monthly usage eligibility requirement?

A. Peoples Gas' S.C. No. 4 is designed for the utility's largest customers. The eligibility requirement helps to ensure that the customers that are served under the service classification are reflective of the types of customers, characteristics, and the costs underlying the charges approved by the Commission.

Q. Why is it appropriate for Peoples Gas to use that same usage criterion as a maximum standard for S.C. No. 2?

A. It is appropriate for Peoples Gas to use the same criterion as a maximum standard for S.C. No. 2, as it exactly mirrors the minimum requirement for S.C. No. 4, thereby eliminating any overlap and not creating a gap between the two service classifications. A maximum usage requirement higher than that already approved for Peoples Gas' S.C. No. 4 would allow an opportunity for certain customers to switch between S.C. No. 2 and S.C. No. 4 for personal benefit, but at the expense of other customers and Peoples Gas. A maximum requirement lower than that for S.C. No. 4, would leave customers with no tariff options for service.

Q. Why is North Shore proposing to add a usage eligibility requirement to S.C. Nos. 2 and 3?

A. North Shore is proposing to add a usage eligibility requirement for S.C. Nos. 2 and 3 to ensure that customers are served under the rate classes for which their costs and charges were derived. This would ensure that North Shore has an opportunity to earn the revenue requirement approved for each service classification and the customers are not adversely affected by customer migration.

Q. Why did North Shore select 41,000 therms for S.C. No. 3?

A. North Shore considered the service decisions of North Shore's former S.C. No. 3 customers subsequent to the last rate case (Docket Nos. 07-0241/07-0242 (cons.)); the threshold approved for Peoples Gas S.C. No. 4, which is, like North Shore S.C. No. 3, a large volume demand classification; usage for the largest North Shore customers; and a desire to reduce the usage disparity and intra and inter-class subsidies among S.C. No. 2 customers, to arrive at North Shore's proposal for a 41,000 average monthly therm threshold. After the new rates arising from North Shore's last rate case went into effect, all S.C. No. 3 customers migrated to S.C. No. 2, the cost of which was below the cost of service for the migrating customers. The actions of these large customers left no customers on S.C. No. 3, and increased the usage disparity for customers on S.C. No. 2, a general service rate. To avoid such inappropriate switching in the future and to minimize the usage disparity and intra and inter-class subsidies on S.C. No. 2, I analyzed bill frequency and annual usage data for North Shore's largest customers to determine whether the minimum eligibility threshold approved for Peoples Gas S.C. Nos. 3 and 4 in Docket Nos. 95-0032 and 07-0241/07-0242 (cons.), respectively, would be appropriate for North Shore's S.C. No. 3. A review of the bill frequency data revealed that 95% of monthly bills (152,000 of about 160,000) were less than 3,000 therms, while about 331 monthly bills were larger than 40,000 therms. If you assume that these bills would be those for North Shore's largest customer, about 28 customers (331 divided by 12 months) should be affected by North Shore's proposals. Given the significant usage difference between the great majority of S.C. No. 2 customers and the group that would transfer to S.C. No. 3, and the minimal number of large customers and bills that would be affected by North Shore's proposed eligibility requirement, North Shore believes that this is an appropriate threshold. No party in this proceeding has shown otherwise.

Q. Why is it then appropriate to use that same usage criterion as a maximum standard for S.C. No. 2?

A. It is appropriate for North Shore to use the same criterion as a maximum standard for S.C. No. 2, as it exactly mirrors the minimum requirement for S.C. No. 3, thereby eliminating any overlap and not creating a gap between the two service classifications. A maximum usage requirement higher than that proposed for North Shore's S.C. No. 3 would allow an opportunity for certain customers to switch between S.C. No. 2 and S.C. No. 3 for personal benefit, but at the expense of other customers and North Shore. A maximum requirement lower than that for S.C. No. 3, would leave customers with no tariff options for service.

Q. Mr. Sackett describes, on page 6 of his direct testimony, the Utilities' proposed usage limitations for S.C. No. 2 as effectively arguing that there should not be customer flow to services subject to Rider VBA. Is this a reasonable inference from the Utilities' proposal?

A. Somewhat, although the Utilities proposals are not as restrictive as described by Mr. Sackett. Under the Utilities' proposals, Peoples Gas S.C. No. 4 customers and North Shore S.C. No. 3 customers, whose usage characteristics are consistent with the proposed eligibility requirements for S.C. No. 2 (which is subject to Rider VBA), would be allowed to migrate to S.C. No. 2. These customers' usage would be consistent with the usage which underlies the Rider VBA baseline established for S.C. No. 2. However, customers whose usage is not consistent with the proposed eligibility requirement for S.C. No. 2 would not be allowed to migrate to S.C. No. 2. These customers' usage characteristics would not be consistent with the usage that underlies the Rider VBA baseline for S.C. No. 2. Migration of large S.C. No. 4 customers, whose usage is not consistent with the usage requirements for S.C. No. 2, would not only affect Peoples Gas' ability to earn its Commission approved revenue requirement for S.C. No. 4, it would result in refunds under Rider VBA arising from such customer migration. This would adversely affect Peoples Gas' ability to earn its Commission approved revenue requirement for S.C. No. 2. The same situation would arise for North Shore if customers with usage larger than the proposed eligibility requirement for S.C. No. 2 were allowed to migrate from S.C. No. 3 to S.C. No. 2.

Q. Would a usage criterion make sense even if the Utilities did not have Rider VBA (see page 8 of Mr. Sackett's direct testimony)?

A. Yes. A usage criterion is necessary to ensure that customers are served under the rate class which reflects the cost to provide service to them and to ensure that such migrations do not adversely impact the Utilities or customers or result in inter or intra-class subsidies.

Q. Mr. Sackett speculates, on page 12 of his direct testimony, that customers may move from S.C. No. 3 (North Shore) or S.C. No. 4 (Peoples Gas) to S.C. No. 2 to receive larger banks without paying standby demand charges. Does an S.C. No. 2 transportation customer with no standby service pay for the Allowable Bank it receives?

A. Yes. S.C. No. 2 transportation customers, including those electing no standby service, pay for base rate Allowable Bank through bundled base rates which reflect the costs of such Allowable Bank.

Q. How do you respond to Mr. Sackett's direct testimony, on pages 11-12 where he states that it "remains unexplained" why there are customers that, under the Utilities' current proposal, would move from S.C. No. 2 to the larger volume rate when the Utilities included them in S.C. No. 2 in the last rate case?

A. The costs set for S.C. No. 2 for Peoples Gas and North Shore in their last rate cases reflect the costs caused by the 51 Peoples Gas and 20 North Shore customers who the Utilities are proposing to transfer to S.C. Nos. 4 and 3, respectively. However, the characteristics for these customers are not consistent with those customers remaining on S.C. No. 2, and are more consistent with each other, or those customers who are served under Peoples Gas' S.C. No 4 or North Shore's S.C. No. 3. For example, the average annual usage for the 51 transferring Peoples Gas customers referred to by Mr. Sackett on page 12 of his direct testimony, is over 800,000 therms while the average annual usage for S.C. No. 2 is only about 8,200 therms. The average annual usage for the 20 transferring North Shore customers, also referred to by Mr. Sackett on page 12 of his direct testimony, is well over 1,000,000 annual therms while the average annual usage for S.C. No. 2 is only 6,600 therms. Transferring these large customers from S.C. No. 2 to S.C. No. 3 (North Shore) or to S.C. No. 4 (Peoples Gas) would not only group these customers with customers with similar characteristics and costs, it would also minimize inter and intra-class subsidies for all of these rate classes.

Q. On page 13 of his testimony, Mr. Sackett states that the Utilities need to further justify their eligibility requirements for S.C. Nos. 2, 3 (North Shore) and 4 (Peoples Gas) with bill impact data. Did the Utilities provide bill impacts for customers transferring from S. C. No. 2 to S.C. No. 3 (North Shore) and S.C. No. 4 (Peoples Gas)?

A. Yes. As acknowledged by Mr. Sackett on page 12 of his direct testimony, the Utilities provided bill impact data in Peoples Gas Ex. VG-1.8, page 5 of 11, and North Shore Ex. 1.8, page 5 of 10, included with my direct testimony. These impacts show that, assuming 25,000 monthly therms or greater, bill increases should range from 3.8% - 5.5% for Peoples Gas, and 2.5% - 4.0% for North Shore, for sales service and transportation service under Rider SST. These impacts are based on the charges that the customers are currently paying under the S.C. No. 2 charges approved in the Utilities' last rate cases and what they would pay under various usage levels under their new service classification. Mr. Sackett has not indicated why such bill impact data is not sufficient.

Q. Mr. Sackett also stated that the Utilities should show how the Allowable Bank would be affected for those customers transferring from S.C. No. 2. Do you have any comments?

A. As these customers would be transferred to a service classification whose rates are unbundled, their Allowable Bank would be affected by their transportation service elections. Customers may elect more or less storage than what was provided under S.C. No. 2.

III. <u>MISCELLANEOUS CHARGES</u>

Q. Do you agree with Staff witness Mr. Boggs' recommendation on page 5 of his direct testimony that North Shore set its succession turn on activation fee at $16.59?

A. North Shore would prefer that the succession turn on activation fee be set at $16.50, which is Mr. Bogg's recommendation rounded to the nearest 50 cents. In the response to the Utilities' data request, PGL-NS-8.06, Mr. Boggs stated that he would not be opposed to this rounding proposal.

Q. Mr. Boggs does not recommend changes to any of the other activation and reconnection charges. However, he generally recommends that, in future rate cases, the Utilities continue to move towards full cost recovery in these charges. Do you agree?

A. Yes.

Q. On page 36 of his direct testimony, Mr. Boggs would condition approval of removing the Peoples Gas Facilities Charge on the approval of a third meter class for S.C. No. 2. Do you believe that the Facilities Charge should be removed even if the third meter class is not approved?

A. Yes. As stated on page 31 of my direct testimony, costs for 781 customer accounts have been reclassified under Account No. 385, resulting in more than a few customers that would require direct billing. As it would be complex and burdensome to provide direct billing for this large number of accounts, the Facilities Charge should be eliminated.

IV. RIDERS

A. Rider ICR - Peoples Gas

Q. Ms. Hathhorn stated that, if the Commission approves Rider ICR, she has six recommendations in the nature of clarifying Rider ICR and five recommendations regarding the calculation of Rider ICR. She also notes Staff witness Mr. McNally makes a recommendation regarding the rate of return to be applied to the assets considered for recovery through Rider ICR. Which of these proposals are you addressing?

A. I am addressing all of Ms. Hathhorn's proposed tariff language changes. Peoples Gas accepts five of the six proposals to clarify Rider ICR and three of the five proposals pertaining to the calculation. The Utilities' witness Mr. Moul addresses Mr. McNally's proposal.

Q. Ms. Hathhorn states, on pages 36-37 of her direct testimony, that her first and second recommendations for language changes to proposed Rider ICR are Peoples Gas' proposals from data responses. Does Peoples Gas accept these two changes?

A. Yes.

Q. Ms. Hathhorn proposed that Rider ICR not become effective until 60 days after the Commission's final order in this proceeding to accommodate review of language changes. She proposed specific Order language on pages 37-38 of her direct testimony. Does Peoples Gas accept this proposal?

A. Peoples Gas does not accept this proposal. Ms Hathhorn has not explained why an extended review period is necessary for this rider. Peoples Gas' filing included Rider ICR. Ms. Hathhorn has included specific tariff language for her proposals, many of which Peoples Gas accepts. At this point, the language for proposed Rider ICR is clear. Even if the Commission's final order requires additional or different changes, addressing those changes in the compliance filing is a routine part of the post-order compliance process. There is nothing extraordinary about Rider ICR that requires an extended review period. I am also advised by counsel that Senate Bill 1918, which I mentioned above, includes specific language addressing the length of the review period for compliance with a Commission decision and that language would incorporate four business days within the suspension period and not to extend the suspension period by more than two business days.

Q. Ms. Hathhorn's fourth recommendation is that the annual reconciliation include a determination of whether costs recovered were prudently incurred, just and reasonable (page 38). Does Peoples Gas agree?

A. Yes.

Q. Ms. Hathhorn's fifth recommendation concerns items that should be part of the annual internal audit (pages 38-39). Does Peoples Gas agree to add this language to Rider ICR?

A. Yes.

Q. Ms. Hathhorn's sixth recommendation is to update the Account 383 percentage (page 39). Does Peoples Gas agree?

A. Yes.

Q. Ms. Hathhorn's seventh recommendation is for the removal of Factor IOM from the rider (pages 39-41). Does Peoples Gas agree?

A. Yes.

Q. Ms. Hathhorn's eighth recommendation is that incentive compensation costs be excluded from recovery under Rider ICR (pages 41-42). Does Peoples Gas agree?

A. Peoples Gas agrees, for purposes of this proceeding, to exclude incentive compensation costs from recovery under Rider ICR. However, this does not mean that Peoples Gas agrees that such costs should not be recovered through rates or waives the right to propose the inclusion of incentive compensation in recovery under Rider ICR in any future proceedings. The Utilities' witness Mr. Hoover addresses the issue of incentive compensation in his rebuttal testimony.

Q. Ms. Hathhorn's ninth recommendation is that there be no Rider ICR charges until the acceleration plan discussed by Staff witness Mr. Stoller is approved by the Commission (pages 42-43). Please comment.

A. The Utilities' witnesses Mr. Schott and Mr. Marano explain how Peoples Gas is addressing Mr. Stoller's proposal. Based on their proposal, it is not necessary to revise Rider ICR for this recommendation.

Q. Ms. Hathhorn's tenth proposal is that the savings associated with moving meters outside be netted against costs in the calculation (page 43). Does Peoples Gas agree?

A. The Utilities' witness Mr. Doerk explains that there are no savings associated with moving meters outside. Based on his testimony, Peoples Gas does not agree to this proposal.

Q. Ms. Hathhorn's final Rider ICR recommendation is that the "actual savings" component be updated at least every three years (pages 43-44). Does Peoples Gas agree?

A. Peoples Gas agrees with Ms. Hathhorn's proposal to update the "actual savings component" every three years. However, Peoples Gas does not agree with all the language proposed by Ms. Hathhorn in her direct testimony. Peoples Gas believes that a triennial update of the factor is sufficient. If the Commission wishes to review the factor more frequently, I understand that the Commission could initiate a proceeding to do so and tariff language is unnecessary for this purpose. Accordingly, the last clause of Ms. Hathhorn's proposal ("but may be updated sooner if demonstrated to be necessary by the Company or any other party") is unnecessary.

B. <u>Rider VBA - Peoples Gas and North Shore</u>

Q. Ms. Hathhorn explains that in the Utilities' last rate order the Commission directed Staff to prepare a report on the Utilities' rates of return and the effect of Rider VBA. She recommends, on page 45 of her direct testimony, that the Utilities prepare that report. Do the Utilities agree?

A. Yes.

C. <u>Rider UEA -- Peoples Gas and North Shore</u>

Q. Mr. Bridal recommended, on pages 9-10 of his direct testimony, that the Utilities add to Rider UEA the following: "The Uncollectible Factors shall be updated only in a general rate proceeding." Do the Utilities agree?

A. Yes. However if Senate Bill 1918 is enacted and the Utilities elect to file a rider to provide for recovery of incremental uncollectible expenses, the Utilities would withdraw their proposed Riders UEA.

Q. Mr. Bridal recommended, on pages 10-11 of his direct testimony, changes to the proposed Uncollectible Factors based on responses to data requests related to the Utilities' March reforecast. What Uncollectible Factors are the Utilities proposing?

A. The Utilities have not updated the Uncollectible Factors based on the March reforecast. The Utilities' witness Ms. Gregor addresses the Utilities' proposals for updating gas costs in her rebuttal testimony. If the Utilities' Rider UEA proposals are approved, the Uncollectible Factors in Rider UEA will be updated to reflect the gas costs approved in this consolidated proceeding.

Q. Staff witness Mr. Lazare, on page 10 of his direct testimony, states that it would be a mistake to approve Rider UEA based on the assumption that gas prices will necessarily rise. If gas prices decline, does Rider UEA benefit customers, relative to base rate recovery of the entire uncollectible expense?

A. Yes. If gas prices decline customers would benefit as they would pay an uncollectible expense amount lower than that approved in base rates.

Q. Do you have any corrections to Rider UEA, as filed by the Utilities?

A. Yes. Peoples Gas filed its proposed Rider UEA as Third Revised Sheet No. 137. This tariff sheet reflects under "Uncollectible Expense Adjustment", an Uncollectible Factor of .0304 for S.C. No. 1, Small Residential. That amount should be corrected to be .0340.

V. LARGE VOLUME TRANSPORTATION PROGRAMS

Q. Mr. Sackett recommends, on page 25 of his direct testimony, that the Utilities revise the "Diversity Factor" in their transportation riders. Do the Utilities agree?

A. Yes. Peoples Gas agrees to reduce its Diversity Factor from 0.87 to 0.86. North Shore agrees to reduce its Diversity Factor from 0.75 to 0.73.

Q. Mr. Sackett, on page 21 of his direct testimony, asks the Utilities to explain in their rebuttal testimony why suppliers under the small volume transportation program receive a storage carrying cost credit, but customers and suppliers under the large volume transportation program do not. Please address Mr. Sackett's question.

A. The credit for the CFY program arose in Docket Nos. 01-0469 and 01-0470, in which the Commission approved the CFY programs. At that time, the large volume transportation programs were not before the Commission. In Docket Nos. 07-0241/07-0242 (cons.), the Utilities' last rate case, the Utilities updated the CFY factors, but such a credit for large volume customers was not at issue. As Mr. Sackett suggests, the inclusion of a minimum inventory requirement for the large volume programs provides a basis for applying such a credit. Accordingly, the Utilities agree that it would be appropriate in this proceeding to develop a storage carrying cost credit for the large volume transportation programs, Riders FST and SST.

Q. How would the Utilities calculate the credit for large volume transportation customers?

A. The derivation of the credit for large volume transportation customers is shown on NS-PGL Ex. VG-2.5P and NS-PGL Ex. VG-2.5N. NS-PGL Ex. VG-2.5P provides the credit for S.C. No. 2 on page 1 and for S.C. No. 4 on page 2. NS-PGL Ex. VG-2.5N provides the credit for S.C. No. 2 on page 1 and for S.C. No. 3 on page 2.

Q. Why are the Utilities providing different credits for S.C. No. 2 and their large volume demand service classifications (S.C. No. 4 for Peoples Gas and S.C. No. 3 for North Shore)?

A. The Utilities are providing different credits because storage costs for S.C. No. 2 are fully bundled in base rates while they are unbundled and recovered through the standby service charge for the large volume demand service classifications. As discussed in the rebuttal testimony of the Utilities' witness Mr. Dobson, the Utilities are not proposing to unbundle standby and storage services at this time.

Q. Would the credits be applied to the customer or the supplier?

A. The credits would be applied to the customer account bills as a stand alone credit.

Q. How would the Utilities modify their tariff to include the credit?

A. The Utilities would modify Rider FST to show the new credit amounts that would be applied on a per therm of MDQ basis. Rider SST would be modified to indicate that for S.C. No. 2 customers, a base rate credit amount would be applied on a per therm of MDQ basis and a gas charge credit amount would be applied on a per therm of Selected

Standby Quantity ("SSQ") basis. For Rider SST S.C. Nos. 3 (North Shore) and 4 (Peoples Gas) customers, the base rate credit and gas charge credit amounts would be applied on a per therm of SSQ basis.

Q. Mr. Sackett, on pages 25 - 42 of his direct testimony, proposes that the Utilities unbundle their Allowable Bank ("AB") from standby service. What is your understanding of Mr. Sackett's "unbundling" proposal?

A. I understand Mr. Sackett to be proposing that a large volume transportation customer may purchase AB without also purchasing standby service. Mr. Dobson addresses the details of this "unbundling" proposal in his testimony.

Q. Have the Utilities ever offered unbundled storage services?

A. Yes. In Docket Nos. 95-0031 and 95-0032, the Commission approved Rider NS (Nominated Storage Service) and Rider SNS (Short Notice Storage Service) for both Peoples Gas and North Shore. These unbundled storage services replaced Peoples Gas' Riders 19 and 21 and North Shore's Riders 17 and 19, which were also unbundled storage services. The Commission also approved Rider TB (Transportation Balancing Service) in the above dockets. Rider TB, which was required for S.C. No. 3 (North Shore) and S.C. No. 4 (Peoples Gas) customers who did not want standby service, included an option to purchase unbundled storage.

Q. Why did the Utilities discontinue these services?

A. The Utilities proposed, and the Commission approved, discontinuance of these services due to lack of customer interest. The discontinuance of North Shore Gas' Rider TB was approved in Docket Nos. 07-0241/07-0242 (cons.). The discontinuance of Peoples Gas'

Rider TB is pending in these proceedings, and no party has opposed eliminating this rider.

Q. Mr. Sackett states, on page 34 of his direct testimony, that the S.C. No. 3 (North Shore) and S.C. No. 4 (Peoples Gas) standby service charge calculation may be "problematic." What is the standby service charge and how is it calculated?

A. The standby service charge recovers unbundled gas supply related costs. These costs, which are included in the Utilities' embedded cost of service studies, arise from investments and expenses related to the Utilities' production and storage functions. It applies to Peoples Gas' fully unbundled S.C. No. 4 customers and North Shore's fully unbundled S.C. No. 3 customers. For transportation customers, the charge would be applied to their elected standby level (from 0% to 100%) while the Utilities' few retail sales customers in these classes would have this charge applied to their billing demand. The Commission approved the recovery of production and storage costs through the standby service charge in Docket Nos. 95-0031, 95-0032 and 07-0241/07-0242 (cons.). The Commission also approved the manner that the charges would be applied, as described above.

Q. Please respond to each of the specific possible problems related to the standby service charge that Mr. Sackett lists on page 34 of his direct testimony.

A. Below is a listing, in italics, of the problems identified by Mr. Sackett and the Utilities' responses:

- *The charge includes storage and production costs.* As discussed above, the Commission approved recovery of storage and production costs through the standby service charge in the Utilities' 1995 and 2007 rate cases.
- *It is calculated on annual usage and demand but recovered monthly*. Mr. Sackett should clarify this problem. It is not clear whether Mr. Sackett is suggesting a problem with the derivation or the billing of the standby service charge. The Utilities determined their respective standby service charges by dividing the annual storage and production-related revenue requirement dollars by the annual applicable standby demand billing units to derive a monthly charge. The Utilities provided workpapers supporting the derivation of these charges. While the presentation of the derivation of the charges differs in this consolidated proceeding from the Utilities' 1995 and 2007 rate cases, the methodology remains unchanged. When the standby service charge was introduced in the Utilities' 1995 rate cases, the presentation of the storage and productions revenue requirements reflected the nature of the reports generated by the Utilities' embedded cost of service studies. As there was no summary derivation of the revenue requirements for the storage and production functions, the Utilities provided reports which reflected their derivation. The Utilities used the same data presentation in the 2007 rate cases. The workpapers submitted in these proceedings are reflective of the reports generated by newer embedded cost of service models, which provide summarized revenue requirements for the storage and production functions.

- *The North Shore charge may include leased storage from Peoples Gas.* This is incorrect. North Shore recovers the cost of leased storage from Peoples Gas through its Rider 2, Gas Charge.
- *The charge is recovered based on the full billing demand and not just the portion associated with on system assets.* As discussed above, the charge is assessed to transportation customers based on their elected standby levels, which can range from 0% to 100%, and to sales customers based on their full billing demand. The Commission approved this manner of recovery in the Utilities' 1995 and 2007 rate cases. Mr. Sackett has not explained why it is no longer acceptable.

Q. Is the standby service charge correctly calculated and charged?

A. Yes. The Utilities' present standby services charges are correctly calculated and charged. The Utilities' proposed standby service charge reflects the storage and production related costs reflected in their embedded cost of service studies and are correctly calculated and assessed to test year billing units. However, I understand that the production costs reflected in Peoples Gas' revenue requirement have been reclassified from Account 813 to Account 856. This reclassification of costs, which is discussed in the rebuttal testimony of the Utilities' witness Ms. Moy, would lower the standby service charge and increase the demand charge for Peoples Gas S.C. No. 4 assuming its proposed revenue requirement.

Q. Mr. Sackett, on page 26 of his direct testimony, states that the standby gas is currently sold at a "three-part charge" of the standby demand charge, standby commodity charge along with the commodity gas charge for system gas. How is standby gas priced?

A. Mr. Sackett's characterization of the pricing for standby gas blurs the lines between "standby service", which gives transportation customers the right to demand that the Utilities stand prepared to provide company-owned gas up to the contracted for level of service and "standby gas", which is the gas commodity that is purchased by transportation customers from the Utilities. Only the standby commodity charge is assessed on standby gas that is purchased by transportation customers. There is no additional commodity gas charge for system gas.

Q. Is the Standby Demand Charge assessed for gas purchased by the customer?

A. No. The Standby Demand Charge is assessed on the level of standby service ("back-up service") elected by the customer. The charge is assessed on the MDQ for transportation customers served under Rider FST (by definition, Rider FST customers elect 100% standby service). The charge is assessed on the SSQ for transportation customers served under Rider SST (these customers may elect 0-100% standby service).

Q. Mr. Sackett, on pages 35-36 of his direct testimony, questioned how the Utilities recover certain capacity costs. Why does the Demand Gas Charge ("DGC") include different costs than the Aggregation Balancing Gas Charge ("ABGC")?

A. As stated above, the DGC (the Standby Demand Charge) is what a customer pays to purchase standby service, which is the right to demand that the Utilities stand prepared to provide company-owned gas up to the contracted for level of service. The Utilities support that service with all their capacity assets. The DGC includes the non-commodity related capacity costs. By contrast, the ABGC is a charge to recover costs associated with the balancing service that the Utilities provide to CFY customers and suppliers. The

CFY customers do not contract for the right to purchase company-owned gas and the ABGC includes only those non-commodity related capacity costs associated with balancing and storage.

Q. Mr. Sackett, on page 36 of his direct testimony, proposes a change to Rider 2 Gas Charge to "enable the AB to be unbundled". Please comment on Mr. Sackett's proposal for a Leased Storage Gas Charge ("LSGC") credit for PGA customers.

A. The Utilities' witness Mr. Dobson, in his rebuttal testimony, describes the deficiencies in Mr. Sackett's proposal to unbundle the AB, the Utilities' non-support for Mr. Sackett's proposal, and how the Utilities use their gas supply portfolios to serve sales and transportation customers. For the reasons addressed in Mr. Dobson's testimony, the LSGC credit proposed by Mr. Sackett is not warranted.

VI. CHOICES FOR YOU^{sm} TRANSPORTATION PROGRAM

Q. Mr. Sackett recommends, on pages 21-22 of his direct testimony, that the storage carrying cost credit that alternative suppliers receive under Rider AGG (Aggregation Service) be applied on a per therm of MDQ basis and not a per account basis. Do the Utilities agree?

A. The Utilities agree with Mr. Sackett's proposal.

Q. Please describe how the Utilities would calculate the per therm of MDQ credit.

A. NS-PGL Ex. VG-2.6 describes how the Utilities would calculate the storage credit on a per therm of MDQ basis. This would be accomplished by substituting the number of customers currently reflected in the divisors (line 10) in Peoples Gas Ex. VG-1.11 and North Shore Ex. VG-1.11 with the MDQ data shown on line 1. The Utilities would also need to update the data on lines 6 and 7 to reflect the return and cost of gas approved in this consolidated proceeding. NS-PGL Ex. VG-2.6 includes a revision to line 7 to reflect the commodity portion of the updated gas costs discussed in the rebuttal testimony of Utilities' witness Ms. Gregor.

Q. RGS witness Mr. Crist testified about the Choices For You^{sm} transportation program ("CFY"). What is CFY?

A. The Utilities' witness Mr. McKendry describes the CFY program in his testimony.

Q. Mr. Crist stated, on page 20 of his direct testimony, that he believes the CFY administrative charges and the LDC Billing Option charges "cover the Companies rendering a bill to the customer and including the Alternative Suppliers costs on that bill." What costs does the Administrative Charge recover?

A. The CFY Administrative Charge recovers the Utilities' cost of administering their CFY transportation programs. The activities and functions and the related costs which underlie the Utilities' proposed CFY Administrative Charges are detailed in Peoples Gas Ex. VG-1.10 and North Shore Ex. VG-1.10.

Q. What is the LDC Billing Option?

A. The LDC Billing Option is an optional billing service offered under Rider AGG to suppliers serving customers in the Utilities' CFY programs. Under the service, the Utilities render bills to CFY customers for charges specified by the supplier. The Utilities also remit customer payments to suppliers.

Q. What costs do the LDC Billing Option charges recover?

A. The LDC Billing Option charges recover the Utilities' cost of rendering a bill with supplier specified charges, on behalf of the supplier and remitting customer payments to the supplier. In Docket Nos. 01-0469 and 01-0470, the Commission concluded that the Utilities should offer this service, approved the charges after finding that the record would support even higher charges and directed the Utilities to include the charges in Rider AGG.

Q. Is Mr. Crist's proposal on pages 20-21 of his direct testimony that the Administrative and LDC Billing Option charges be eliminated and the costs recovered in S.C. Nos. 1 and 2 base rates an appropriate way to recover these costs?

A. No. The costs that are recovered under the Administrative and LDC Billing Option charges arise from costs that are caused by the Utilities' CFY programs. Including such costs in base rates would result in sales customers paying for costs caused by transportation customers. The Utilities' current and proposed rates reflect higher base rates for sales customers (and lower for transportation customers) to recognize costs that are not caused by transportation customers (namely, gas cost related bad debt). The Administrative and LDC Billing Option charges should be set based on the same principles.

Q. Would the Utilities need to make any tariff revisions to address issues raised in this proceeding for the CFY program?

A. Yes. The Utilities and Staff witness Mr. Sackett agree that the storage credit for Rider CFY customers should be applied on a per therm of MDQ basis rather than a per customer basis. Currently this credit reduces the Aggregation Charge in Rider AGG. The Utilities propose to apply the storage credit as a standalone credit to customers' MDQ. This would necessitate a new "Storage Credit" rate in Rider CFY. Rider AGG would only need to be revised to reflect the Aggregation Charge that will be approved in this consolidated proceeding.

Q. Are there any other issues that would require tariff changes for the Utilities transportation riders?

A. Yes. In the definition of Maximum Daily Quantity ("MDQ") in Riders FST, SST and CFY, the Utilities had proposed to add the phrase "rounded to the nearest dekatherm" to the definition to clarify how the Utilities calculate the MDQ. However, Mr. McKendry has proposed that the Utilities would not perform this rounding. Accordingly, if the Commission approves Mr. McKendry's proposal, the proposed change to MDQ is unnecessary.

Q. Does this conclude your rebuttal testimony?

A. Yes.