STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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

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REPLY BRIEF ON REHEARING
OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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NOW COME the Staff witnesses of the Illinois Commerce Commission ("Staff"), by and through their undersigned counsel, pursuant to Section 200.830 of the Illinois Commerce Commission's Rules of Practice (83 Ill. Adm. Code 200.830), and respectfully submit their Reply Brief on Rehearing.

I. INTRODUCTION

On April 29, 2008, Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or "Company") filed with the Illinois Commerce Commission ("Commission") revised tariff sheets in which it proposed a general increase in gas rates pursuant to Article IX of the Illinois Public Utilities Act ("Act" or "PUA"), 220 ILCS 5/9. On March 25, 2009, the Commission entered an Order ("Order") which decided, among other things, to include the balance of short-term debt in the Company's capital structure for ratemaking purposes. Accordingly, the Commission adopted a short-term debt balance of $255,640,082 in its Order. On April 24, 2009, the Company filed a Petition for Rehearing on this issue of short-term debt, which was granted by the Commission on May 13, 2009.

II. ARGUMENT

Nicor Gas' Initial Brief on Rehearing continues to argue against the inclusion of any short-term debt in the capital structure for ratemaking purposes. Nicor Gas failed to produce any evidence to support its position that short-term debt is not financing rate-base assets. Instead, the Company maintained its position that short-term debt should not be included because the Commission has not included it in Nicor Gas' capital structure for ratemaking purposes in the past. As a middle course, the Company proposes to impute the balance of short-term debt to equal no more than the amount of cash working capital ("CWC") in rate base. A preponderance of the evidence in the record of this proceeding supports Staff's position that short-term debt is financing rate base assets. The balance of short-term debt included in the capital structure adopted by the Final Order in this proceeding should be upheld. (Docket No. 08-0363, Order, Mar. 25, 2009, pp. 48-49, 51)

A. Capital Structure

The record in this case and the arguments claiming to summarize that record present a lot of confusing and misleading information regarding Nicor Gas' capital structure. Nicor Gas' actual capital structure does not comprise 0% short-term debt, 43.11% long-term debt, 0.12% preferred stock and 56.77% common equity as the Company proposed. Nor does Nicor Gas' actual capital structure comprise 18.21% short-term debt, 35.27% long-term debt, 0.10% preferred stock and 46.42% common equity as Staff proposed and the Commission adopted. Both of the proposed capital structures include adjustments to reflect imagined or real regulatory practices. Nicor Gas' actual capital structure, exclusive of any adjustments, comprises 19.36% short-term debt, 34.77% long-term debt, 0.10% preferred stock and 45.77% common equity. These three capital structures are shown in Appendix A. (See attached) In accordance with Commission practice, Staff's capital structure proposal, which the Commission adopted, removed both short-term debt and long-term capital that a Commission rule (see Staff Ex, 5.0, p. 6) assumes to support construction work in progress ("CWIP").

As Staff witness Freetly explained, money is fungible and as such, cannot be traced from source to use. Since money is fungible, financial theory assumes that all assets are financed with the same mix of capital. Nevertheless, regulation departs from this financial assumption at times. The method of calculating the allowance for funds used during construction ("AFUDC") rate on CWIP, which by rule assumes that short-term debt is the first source of financing for CWIP, is an obvious example of a regulatory exception to the concept of the fungible nature of capital. (Staff Ex. 5, pp. 6-7) Thus, because a Commission rule allocates short-term debt to CWIP first, Staff reduced the balance of short-term debt available to support Nicor Gas' rate base by the amount that rule assigns to CWIP.[1]

The Company can point to no other Commission practice that assumes that short-term debt is the first source of financing for any other non-rate based asset. Further, the Company can point to no Commission practice or rule that assigns other sources of capital exclusive of short-term debt to rate based assets. Despite the fungible nature of money, and the absence of any Commission policy or rule (excepting the CWIP financing rule) that assigns specific sources of funds to specific categories of assets, rate based or otherwise, the Company proposes to limit the amount of short-

[1] Following the AFUDC rule, Staff also allocated a portion of Nicor Gas' long-term debt, preferred stock and common equity to CWIP. (Staff Ex. 5, p. 7)

term debt included in the capital structure for ratemaking purposes to the amount of CWC in rate base. (Co. IB on Rehearing, pp. 5-6) This proposal implies that the Commission should assume that 100% of the Company's CWC is financed with short-term debt and 0% of the other components of rate base are financed with short-term debt.

B. Short-Term Debt is Not an All or Nothing Proposition

It is **not** Staff's position that the inclusion of any short-term debt in a utility's capital structure automatically triggers the inclusion of all the utility's short-term debt.[2] (Co. IB on Rehearing, p. 10) As explained above, Staff excludes short-term debt assigned to CWIP. Staff also examines a utility's use of short-term debt for other legitimate exceptions. For example, in the last Ameren Illinois Utilities rate cases, Staff proposed removing the utilities' contributions to the Ameren Utility Money Pool in those instances where there was a clear, proximate connection between a company's short-term debt balance and its contributions to the utility money pool to avoid double counting bank loans from Ameren's credit facilities.[3]

One justification for reducing the balance of short-term debt included in the capital structure for rate making purposes would be a demonstration that short-term debt is financing assets that are not included in the utility's rate base in excess of short-term's debt proportion to total capitalization, i.e., 18.21%. In this case, Nicor Gas has

[2] At oral argument, Staff counsel stated that the short-term debt issue was an all or nothing proposition. (Tr., Mar. 17, 2009, pp. 32-33, 44) Staff counsel's response was specific to this case, where it is Staff's position that all of the short-term debt, exclusive of CWIP accruing AFUDC, be included since Nicor Gas did not provide any evidence that short-term debt is funding non rate base assets to justify a reduction in the balance.

[3] The Commission ultimately adopted Staff's alternative proposal to remove "excess" cash balances from the short-term debt balances for each of the Ameren Illinois Utilities. (Docket Nos. 07-0585 to 07-0590 Cons., Order, Sept. 24, 2008, pp. 161-165)

alleged, either explicitly or implicitly, that short-term debt composes more than 18.21% of the capital invested in three costs: (1) gas costs not in rate base (Co. IB on Rehearing, pp. 4 and 16); (2) margin calls (*Id*. and Petition for Rehearing, pp. 2 and 5); and (3) cash working capital (Co. IB on Rehearing, pp. 5 and 16-17).[4] Despite the fact that the Company provided no evidentiary support for its position at any stage of this proceeding, Staff investigated those allegations. Staff found that the Company's rate base contains highly seasonal components that require a seasonal source of short-term funding. Staff also found that the Company's seasonal usage of short-term debt correlates very highly with the Company's seasonal rate base components. (Staff IB, pp. 37-38) The Order's disposition of the short-term debt issue was consistent with Nicor Gas' use of short term debt. The Commission should affirm its decision to include the average outstanding balance of short-term debt (less the CWIP adjustment) in the Company's capital structure for rate making purposes. (Staff IB on Rehearing, pp. 3-6)

1. Non-Rate Based Gas Costs

The Company claims that it will finance $337.2 million in 2009 gas costs that are outside rate base with sources that include short-term debt. (Co. IB on Rehearing, p. 16) The Company's brief is more noteworthy for what it does not say than what it says regarding those gas costs.

First, the Company does not specify what percentage of those gas costs are funded with short-term debt. Clearly, the "non-rate based" gas costs cannot be financed 100% with short-term debt since the average balance of the former exceeds the

[4] For short-term debt to compose <u>less</u> than 18.21% of the capital invested in rate base, it follows that short-term debt must compose <u>more</u> than 18.21% of the capital invested in gas not in rate base, margin calls, and cash working capital.

average balance of the latter. As such, the observation that a portion of the Company's gas costs are not in rate base provides the Commission with no assistance in determining what portion of the Company's short-term debt should be included in the ratemaking capital structure. Nicor Gas' position implies that short-term debt is financing gas costs not in rate base but not gas costs in rate base. Nicor Gas provides no argument, let alone evidence of how these inconsistent results could possibly occur.

Second, the Company does not explain why it has not sought to include the additional $337.2 million in 2009 gas costs in rate base. Obviously, the Company would have included the $337.2 million, which would amount to a 25% increase to its rate base, if it could be properly included in rate base. The $337.2 million in 2009 gas costs are not included in rate base because of the arcane details of gas inventory accounting. As explained below, the hypothetical example presented by the Company in Rehearing Ex. 4 illustrates how gas inventory accounting works.   This example lays to rest the false notion that short-term debt finances any gas costs excluded from rate base, let alone in excess of the 18.21% of capitalization which short-term debt composes.

The Company records gas costs on its balance sheet on a "last in, first out" ("LIFO") basis, meaning the cost of gas withdrawn from inventory is assumed to equal the cost of the gas most recently injected into inventory. (Rehearing Ex. 4) Consequently, in an environment of rising gas prices, the cost of gas remaining in inventory (i.e., the oldest layers) can be much lower than the replacement cost of gas. In Rehearing Ex. 4 the Company assumes the hypothetical January 1, 2008 historical cost of the 70 million MMBtu of gas in inventory is $1.50/MMBtu, or $105 million. In contrast, the hypothetical replacement cost of gas is $8.00/MMBtu, reflecting an environment of rising gas prices. During January 2008, 20 million MMBtu of gas are withdrawn from storage for sale. Although the original cost of that gas is $1.50/MMBtu, the utility charges customers the, higher, $8.00/MMBtu replacement cost of gas. That is, the utility collects $160 million in gas charges (20 million MMBtu of gas sold x $8.00/MMBtu replacement gas cost) rather than $30 million in gas charges (20 million MMBtu of gas sold x $1.50/MMBtu original gas cost) for the gas customers consumed during January 2008. Rehearing Ex. 4 illustrates similar withdrawals of gas in February and March 2008, such that a total of 50 million MMBtu of gas are withdrawn from storage during those three months with a total original cost of $75 million ($1.50/MMBtu x 50 million MMBtu of gas) for which the utility charges customers a total replacement cost of $400 million ($8.00/MMBtu x 50 million MMBtu of gas). That is, from January to March 2008, the utility charges customers $400 million for gas that originally cost the utility $75 million.

The $325 million difference between the amount the utility charged for gas during the January to March 2008 period and the original cost of gas is booked to a liability account called "Temporary LIFO Liquidation." The month by month breakdown of the $325 million booked to "Temporary LIFO Liquidation" is illustrated in Rehearing Ex. 4: $130 million of gas costs are booked to "Temporary LIFO Liquidation" in January 2008; $162.5 million of gas costs are booked to "Temporary LIFO Liquidation" in February 2008; and $32.5 million of gas costs are booked to "Temporary LIFO Liquidation" in March 2008.

The $325 million in excess gas charges[5] would be a windfall for the utility but for one additional factor: the utility reverses the excess when it injects gas into storage. This is illustrated in the example for April 2008 in Rehearing Ex. 4. In that month, the utility buys 10 million MMBtu of gas at $8.00/MMBtu, or $80 million in total. Nevertheless, because the company built up a Temporary LIFO Liquidation balance of $325 million by charging customers the replacement cost of gas rather than the original cost of gas, the company does not increase gas inventory by $80 million. Rather, the company restores a portion of the $1.50/MMBtu gas inventory it sold for $8.00/MMBtu during January, February and March. The $65 million difference between the amount paid for the gas and the amount booked to gas in storage is deducted from "Temporary LIFO Liquidation."

In summary, gas costs are booked to Temporary LIFO Liquidation whenever gas is withdrawn from inventory at a time that the replacement cost of gas exceeds the original cost of gas. That is, because customers are charged the (typically higher) replacement cost of gas rather than the historical (i.e., inventory) cost of gas, Temporary LIFO Liquidation represents the dollar amount that gas sales customers paid to the company in excess of the original cost of that gas. The utility reimburses customers for those excess payments when it effectively reconstitutes gas inventory at $1.50/MMBtu, deducting the $6.50/MMBtu difference between replacement cost and original cost from Temporary LIFO Liquidation.

[5] Staff uses the term "excess" strictly in mathematical terms, that is, "the amount or degree by which one thing or quantity exceeds another." (Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/excess, definition (1)(b)) Staff implies no connotation regarding the appropriateness of the practice that leads to such an excess.

Returning to the Company's 2009 test year gas inventory, Rehearing Ex. 4 illustrates that Nicor Gas excluded $337.2 million of its $432.8 million of gas costs from rate base because Nicor Gas forecasted that customers will prepay Nicor Gas $337.2 million in gas costs during 2009. That is, customers will advance Nicor Gas $337.2 million for the purchase of gas later in the year. It is a basic tenet of traditional ratemaking that customer supplied funds are deducted from rate base.[6] Thus, the Company's argument that a portion of its $337.2 million in non-rate based gas costs are financed with short-term debt is contradicted by the manner in which the Company books and recovers gas costs.[7] Costs that are financed with ratepayer money cannot be financed with investor-supplied capital, including short-term debt.

2. Margin Calls

The Company now claims that it relies on short-term debt to fund margin calls for gas purchases. (Co. IB on Rehearing, p. 4, see also Petition for Rehearing, pp. 2 and 5) Nicor Gas' claim is not supported by any evidence in the record. The Company presented no data regarding these non-rate base investments. The first mention of margin costs for gas purchases occurs in the Company's Petition for Rehearing (p. 2), which stated "The evidence demonstrates that Nicor Gas uses short-term debt to finance non-rate base assets, including $337 million in actual gas storage inventory costs and $200 million in margin costs for gas purchases" citing to Nicor Gas Ex. 43.0, p. 8, ll.174-85. However a review of the testimony cited reveals that the witness did not

[6] For example, see rate base deductions for Customer Deposits, Budget Payment Plan Balances and Customer Advances for Construction. Order Appendix A, p. 4.

[7] The Company's gas inventory in rate base is effectively a net of the entire $432.8 million of gas inventory and "Temporary LIFO Liquidation." That is, rate base would not change if the entire $432.8 million in gas costs were included as a rate base addition as long as the funds customers supplied to purchase gas through their prepayments (i.e., "Temporary LIFO Liquidation") were recognized as a rate base subtraction.

mention margin costs. The record contains nothing about what amount of margin calls, if any, the Company included in its 2009 forecast, which Staff relied on to determine the 2009 balance of short-term debt. The Company provided actual margin call balances (not 2009 test year balances) for the first time in response to Staff Data Request JF 17.01 (Rehearing Ex. 7), which was sent after the Petition for Rehearing was granted. While Rehearing Ex. 7 reveals substantial margin calls during the first three months of 2009, it also reveals that the actual balances of short-term debt for the December 2008 through March 2009 period exceeded the forecasted balances presented in Schedule D-2 by over $300 million on average. The Company's brief statement with regard to margin costs does not demonstrate that those costs are being funded by short-term debt. Had the Company shown it had forecasted that it would have to meet margin calls during the 2009 test year and that the Company had forecasted issuing short-term debt to fund those margin calls, Staff would have considered adjusting the balance of short-term debt for rate making purposes accordingly. However, the Company never did this.

3. Cash Working Capital

Nicor Gas offers a proposal to limit the balance of short-term debt imputed in the capital structure for ratemaking purposes to equal no more than the amount of CWC in rate base, or $62.6 million. (Co. IB on Rehearing, pp. 5-6, 18) The Company's comparison of short-term debt to CWC (*Id.*, p. 5) is misleading.

First, the fact that cash leads and lags are lumped together into one single CWC number should not mislead the Commission into believing that the cash leads exclusively finance the cash lags, in other words that one can trace the funds provided by the cash leads to the funds used by the cash lags. The use of one single CWC number is a convenience, not a financial principle. Each cash lead and lag was calculated independently (e.g., the cash lead for payroll has no effect on the cash lag for revenue or vice versa) and could have been as easily presented as separate items on the Rate Base schedule on page 4 of Appendix A to the Order, as it was presented on page 8 of Appendix A to the Order.

Nicor Gas claims that the Order mischaracterizes the Company's testimony in concluding that the Company "routinely uses short-term debt to finance its CWC requirements."[8] Although the Company did not admit that short-term debt is financing CWC, the Company is essentially arguing that the seasonal balance sheet items are transformed into permanent long-term assets through the mathematical computation used to determine CWC. The mathematical computation of CWC does not change the nature of the inputs used in the calculation. The Order correctly saw through Nicor Gas' incorrect characterization of CWC in concluding that the components of CWC remain seasonal, short-term assets that are funded with short-term debt. (Order, p. 48)

Second, Nicor's attempt to link short-term debt to CWC alone ignores gas in storage, which also has a highly seasonal component. Nicor Gas' seasonal, cycled gas inventory purchases are and have always been financed through the issuance of short-term debt. This was established in Docket No. 00-0620. (Docket No. 00-0620, Order on Rehearing, Jan. 3, 2002, p. 14) Nicor Gas' use of short-term debt has not changed in any respect. (Co. IB on Rehearing, p. 2) The fact that the Company's gas in storage is financed with short-term debt is consistent with and

[8] Co. IB on Rehearing, p. 16, footnote 13.

corroborates Staff's analysis and leads to the conclusion that the Company is funding the rate base component gas in storage with short-term debt.

Third, core to the Company's proposal is an assumption that the cash lead portion of CWC (i.e., various types of accounts payable and accrued liabilities) finances **only** the lag portion of CWC (i.e., accounts receivable). In other words, the Company traces cash leads to a particular cash lag. However, the Company's analysis is flawed in that the Company has not shown that CWC cash leads are funding the CWC cash lags, exclusively. Staff's analysis showed that the revenue lag component of CWC, accounts receivable, requires a seasonal source of funding and that the monthly balances of short-term debt exhibit the same pattern as the sum of accounts receivable and gas in storage. (Staff IB on Rehearing, p. 5) Staff also performed a correlation analysis on the other components of CWC, which shows that only one of the expense leads, other accrued taxes, arguably follows the same pattern as the sum of accounts receivable and gas in storage. (See Table 1 below and Appendix B) These correlations demonstrate that the revenue lead components of CWC cannot be financing the seasonal cash required to finance the revenue lead of CWC (i.e., working capital) and gas in storage.

Rehearing Ex. 5 reveals where the various expense lag components of CWC are accounted for on the Balance Sheet as Current Liabilities.[9] Using the data from

[9] The CWC component Employee Benefits is accounted for on the Balance Sheet under Other Current Liabilities. The CWC components Payroll and Withholdings, Natural Gas Purchases, Other Operations and Maintenance, Inter-Company Billings and Energy Assistance Charges are accounted for on the Balance Sheet as Accounts Payable and Accrued Liabilities. The CWC components Federal Insurance Contributions (FICA), Federal Unemployment Tax, State Unemployment Tax, Invested Capital Tax, Gross Receipts/ Municipal Utility Tax, Illinois Gas Use Tax, Illinois Gas Revenue Tax, and Property/ Real Estate Tax are accounted for on the Balance Sheet as Other Accrued Taxes. The CWC component Interest Expense is accounted for on the Balance Sheet as Accrued Interest. The CWC components

Rehearing Ex. 5, Rehearing Ex. 2 and Staff Group Cross Ex. 1 – Co. Response to JF 4.04, Staff performed a correlation analysis on the 2007 and 2008 monthly balances of each of those balance sheet accounts and the sum of gas in storage and accounts receivable (the revenue lag component of CWC). The correlation coefficient between Other Current Liabilities and the sum of accounts receivable and gas in storage is 0.08. (See Appendix B, Graph 1) The correlation coefficient between Accounts Payable and Accrued Liabilities and the sum of accounts receivable and gas in storage is -0.05.[10] (*Id*., Graph 2) The correlation coefficient between Other Accrued Taxes and the sum of accounts receivable and gas in storage is 0.51.[11] (*Id*., Graph 3) The correlation coefficient between Accrued Interest and the sum of accounts receivable and gas in storage is -0.26. (*Id*., Graph 4) The correlation coefficient between Accrued Income Taxes and the sum of accounts receivable and gas in storage is -0.12. (*Id*., Graph 5) This correlation analysis shows the weak relationship between the current liability accounts that contain the cash lead components of CWC and the sum of gas in storage and accounts receivable. (*Id*., Graph 6) The results of Staff's correlation analysis are summarized below in Table 1. This shows that the cash leads (rows 6 - 25 of Appendix A, p. 8 to the Order) cannot be funding the cash lags (rows 1 – 4 of Appendix A, p. 8 to the Order). The high correlation coefficient between the monthly balances of short-term debt and the sum of gas in storage and accounts receivable shows that short-term debt

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Federal income Tax and State Income Tax are accounted for on the Balance Sheet as Accrued Income Taxes.

[10] A negative correlation indicates two variables tend to move in opposite directions. Obviously, a source of funds that is negatively correlated with a use of funds, such as accounts receivable, is not assisting the company to finance that use of funds.

[11] Even if one concludes that Other Accrued Taxes is a direct source of funding for Accounts Receivable, the net of the revenue lag for Accounts Receivable ($365,724,000) and the revenue leads that are accounted for as Other Accrued Taxes ($14,045,000) is $351,679,000. This net revenue lag still exceeds the balance of short-term debt included in the capital structure for ratemaking purposes.

is the source of funds for those seasonal components of rate base. (Staff Initial Brief on Rehearing, p. 5)

Table 1

CWC Component	Balance Sheet Account	Correlation Coefficient
Employee Benefits	Other Current Liabilities	0.08
Payroll & withholdings Natural Gas Purchases Other Operations & Maintenance Inter-Company Billings Energy Assistance Charges	Accounts Payable and Accrued Liabilities	-0.05
Federal Insurance Contributions (FICA) Federal Unemployment Tax State Unemployment Tax Invested Capital Tax Gross Receipts/ Municipal Utility Tax Illinois Gas Use Tax Illinois Gas Revenue Tax Property/ Real Estate Tax	Other Accrued Taxes	0.51
Interest Expense	Accrued Interest	0.26
Federal Income Tax State Income Tax	Accrued Income Taxes	-0.12
	Short-term Debt	0.71

Staff has shown that short-term debt is funding gas in storage and the revenue lag component of CWC, accounts receivable. The sum of gas in storage and the revenue lag component of CWC included in rate base is over $461 million, which greatly exceeds the approximately $255 million balance of short-term debt included in the capital structure in the Final Order. Hence, the evidence in the record of this proceeding does not support a reduction in the balance of short-term debt for ratemaking purposes.

C. Arguments Beyond the Scope of Rehearing

In reality, the bulk of the Company's argument is not on how much short-term debt should be included in its capital structure, but on whether short-term debt should be included in its capital structure, even though the Commission notice stated that the "… Petition for Rehearing is granted to consider whether the entire amount of short-term debt should be included in Nicor's capital structure for ratemaking purposes, and is denied as to all other issues." (Notice of Commission Action, May 13, 2009) The Company agreed that the issue on rehearing is "Whether an amount of short-term debt, other than the entire average balance of short-term debt (and greater than $0), should be included in Nicor Gas' test year capital structure?". (Identification of Issue on Rehearing, June 4, 2009)

Although Nicor Gas argues that the determination of the issue must be based only on the record, without a hint of irony, the Company then proceeds to base its position, in part, on allegations outside the record (e.g., Nicor Gas' forecasted test year margin calls and Peoples Gas' and ComEd's short-term debt balances). As discussed above, the few record-based arguments the Company advanced have disintegrated upon examination. The Company's arguments regarding whether short-term debt should be included in its capital structure and based upon matters outside the record should also be dismissed for the following reasons.

First, the Company cites the Commission's Order in its 2004 rate case. (Co. IB on Rehearing, p. 7) The record in this case differs from that in the Company's 2004 rate case in two important ways. Staff provided analysis in this case that it did not provide in 2004 to further demonstrate that Nicor Gas is using short-term debt to finance rate base assets. Staff's analysis showed that the Company's seasonal usage of short-term debt correlated very highly with the Company's seasonal rate base components. (Staff IB on Rehearing, p. 4) Further, the Company's 2004 rate base did not include CWC. (Docket No. 04-0779, Order, Sept. 20, 2005, Appendix A, p. 5)

Second, Nicor Gas disputes that Staff's list of prior orders put forward at oral argument shows a trend by the Commission to include short-term debt in the utilities' capital structures for ratemaking purposes. (Co. IB on Rehearing, p. 11) The Company notes that the amount of short-term debt to be included in the companies' capital structures was agreed upon for the purposes of many of those rate case proceedings. Again, this argument concerns whether short-term debt should be included in rate base, not how much short-term debt should be included in rate base. Notwithstanding the fact that this argument is clearly outside the scope of rehearing, the absence of a contested issue demonstrates that most utilities recognize that short-term debt supports their respective rate bases. Nicor Gas wants to be an exception to the rule. Nicor Gas uses copious amounts of short-term debt but wants the Commission to authorize a rate of return that far exceeds its cost of capital by not factoring in the lower cost of short-term debt.

Third, the Company also disputes Staff's contention that 83 Ill. Admin. Code 285 was revised to formalize the Commission's position on short-term debt. Again, this argument concerns whether short-term debt should be included in rate base, not how much short-term debt should be included in rate base. Notwithstanding the fact that this argument is clearly outside the scope of rehearing, and while Staff agrees that it is administrative in nature, 83 Ill. Admin. Code 285 clearly recognizes the consequences of the fungible nature of capital when it states that by default, short-term debt should be included in the capital structure. Section 285.4010 states "Short-term debt shall be included in the capital structure unless the utility demonstrates that short-term debt is entirely financing assets, such as CWIP or seasonal working capital, that are not included in the utility's rate base." The language gives the utility the opportunity to demonstrate that short-term debt is financing non-rate base assets. Essentially, Section 285.4010 sets forth what Nicor Gas has conceded: that the utility has the burden of proof. (Co. IB on Rehearing, p.3) The clear implication of a utility's failure to meet this burden is that all of short-term debt is included in the capital structure due to the fungible nature of capital. Nicor Gas has repeatedly failed to convincingly meet its burden despite multiple opportunities through direct, rebuttal, and surrebuttal testimony and a reopened record on rehearing. The evidence presented by Staff supports the Order's finding that the utility's test year average outstanding balance of short-term debt (minus CWIP accruing AFUDC) is supporting rate base assets.

Fourth, the Company refers to other recent rate proceedings where short-term debt was not included in utility capital structures for ratemaking purposes. (Co. IB on Rehearing, p. 13) This argument also concerns whether short-term debt should be included in rate base, not how much short-term debt should be included in rate base. Notwithstanding the fact that this argument is clearly outside the scope of rehearing, as shown below, those references are irrelevant to the facts at issue here. Nicor Gas continues to cite to the 2007 Peoples Rate Case. (Co. IB on Rehearing, p. 13, citing Docket Nos. 07-0241-07-0242 Cons., Feb. 5. 2008, p. 76) As pointed out by Staff counsel at oral argument, there is no evidence concerning Peoples' actual short-term debt balances from the Peoples' rate case in the record in this proceeding. (Tr., Mar. 17, 2009, pp. 22-24) In that proceeding, Peoples Gas proposed, Staff supported and the Commission adopted a hypothetical capital structure that contained a lower proportion of common equity than Peoples Gas' capital structure and that excluded short-term debt. The Order in the Peoples Gas case does not present Peoples Gas' capital structure with short-term debt; therefore, one cannot tell from the Order whether Peoples Gas' capital structure with short-term debt had a higher or lower common equity ratio than its imputed capital structure. That is, one cannot tell from the Order whether Peoples Gas' authorized rate of return would be lower with the hypothetical capital structure, which excluded short-term debt, or with its actual capital structure including short-term debt. Nonetheless, at least one very important difference between the Peoples Gas rate case and this rate case is evident. Unlike Peoples Gas, Nicor Gas did not propose lowering its common equity ratio through the use of an imputed capital structure in this case.

The Company also cites the most recent Commonwealth Edison Company ("ComEd") rate proceeding. (Co. IB on Rehearing, p. 13 citing Docket No. 05-0597, July 26, 2006, p. 115) There is nothing in the record in this proceeding regarding ComEd's use of short-term debt. There is nothing in the Order from that case that indicates what amount of short-term debt, if any, ComEd had outstanding during the capital structure measurement period. If the facts were different than the facts in this proceeding, for example if ComEd had no, or had so little short-term debt that it did not significantly affect the cost of capital, then setting the short-term debt balance to zero for ratemaking purposes does not provide insight into the appropriate short-term debt balance in this case.

The 2001 CILCO rate case cited in Nicor Gas' Initial Brief on Rehearing (pp. 3, 8-9, citing to Docket No. 01-0465, Order, Mar. 28, 2002, pp. 68-69) is unique. In no subsequent rate proceeding has the Commission adopted the approach it took in Docket No. 01-0465 to determine the short-term debt balance for the ratemaking capital structure (i.e., limiting the balance of short-term debt to the minimum level during a calendar year). In fact, in the subsequent CILCO rate case, the Commission accepted Staff's approach to determining the balance of short-term debt, which is identical to the method Staff used in this case. (See Order, p. 104, Nov. 21, 2006, Docket Nos. 06-0070/06-0071/06-0072 Cons.)

Nicor Gas argued that both the amount and percentage of short-term debt imputed into the Company's capital structure by Staff would exceed that for any other major Illinois utility and cites to recent Commission rate-setting Orders for the Ameren Illinois Utilities, ComEd, and North Shore Gas Co. and Peoples Gas Light & Coke Co. (Co. IB on Rehearing, p. 2) A higher percentage of short-term debt was included in the Nicor Gas' capital structure because Nicor Gas' <u>use</u> of short-term debt exceeds that of every other major Illinois utility. Further, the Commission has adopted a short-term debt ratio nearly as high as the 18.21% adopted in the Final Order for Nicor Gas; in Docket Nos. 06-0070/06-0071/06-0072 (Cons.), the Commission approved a 16.13% short-term debt ratio for CILCO. (Order, Nov. 21, 2006, p. 149)

D. Short-Term Debt in a Capital Structure Does Not Render It "Hypothetical"

Nicor Gas repeatedly uses the term "hypothetical" in a manner that differs from the ordinary use of the term in regards to capital structures in Commission proceedings. Throughout this proceeding, Nicor Gas labeled Staff's proposed capital structure "hypothetical" because Staff included short-term debt, which the Company did not include in its proposed capital structure. (See, for example, Co. IB on Rehearing, p. 2) The inclusion of short-term debt in a capital structure does not render it hypothetical, where, as in this case, it is based upon the Company's actual capital structure. In Docket Nos. 06-0070/06-0071/06-0072 (Cons.), the Commission did not refer to the capital structures it adopted that include short-term debt as "hypothetical." To the contrary, it explicitly rejected the use of the "hypothetical" capital structures that the Interveners proposed. In the order in that proceeding, the Commission explicitly describes CILCO's capital structure, comprising in part 16.13% short-term debt, as an "actual" capital structure.[12] Clearly, Staff is not proposing to use a hypothetical amount of short-term debt. The Commission should not be misled into believing the capital structure it adopted in this case is "hypothetical" in any commonly understood meaning of that word.

E. Commission Policies Are Not Static

The Company claims that if the Commission bases the amount of short-term debt on the CWC asset, then the Company's capitalization would equal 91% of rate base.

[12] As the citations make clear, the Order uses the terms "hypothetical and "imputed" interchangeably, as did Staff's testimony in this case. Order, Docket Nos. 06-0070/06-0071/06-0072 (Cons.), Nov. 21, 2006, pp. 89-92, 98-99, 101-105.

The Company asserts that this is reasonable since Nicor Gas' capitalization has been between 87% and 93% of rate base since its 1981 rate case. (Co. IB on Rehearing, p. 5) However, the Company offers no explanation of why it is reasonable for capitalization to be that much less than rate base and how it will not result in over-earnings due to the exclusion of short-term debt from its capital structure for ratemaking purposes. (Staff IB, pp. 40-41)

It is a basic finance tenet that all assets must have a source of funding. Therefore, a large discrepancy between rate base and capitalization merits investigation. (Staff Ex. 18.0C, p. 13) Without analysis of why the ratio is valid, the Company's comparison of its ratio of rate base to capitalization in previous cases is not an argument from which Commission decisions can be made; it is only a statistic. Nicor Gas presents no relevant facts from those proceedings regarding the state of the record or the state of the Commission's policy regarding the inclusion of short-term debt in a utility's capital structure. The Company's argument that it has not changed its use of short-term debt is irrelevant. If the Commission was limited to repeating what has been done in the past, the Company would not be recovering 80% of its fixed costs through monthly customer charges, CWC would not be a component of the Company's rate base, and the weather-normalized sales would still be calculated from a 30-year average. (See Order, Docket No. 08-0363 pp. 129-137 and 11-12; Order, Docket No. 04-0779, Sept. 20, 2005, pp. 56-57)

The Commission similarly reversed its treatment of short-term debt in two different 1999 rate cases for MidAmerican Energy Company ("MEC"). In Docket Nos. 99-0122/99-0130 Cons. (MEC electric delivery service rate case), the Commission ruled in agreement with MEC and excluded short-term debt from the capital structure. The Order in that case concluded that the low or zero balances of short-term debt and the consistent refinancing of short-term debt annually showed that short-term debt did not provide a permanent source of capital for long-term assets. (Order, Docket Nos. 99-0122/99-0130 Cons., Aug. 25, 1999, p. 7) However, in Docket No. 99-0534 (MEC gas rate case), the Commission ruled in agreement with Staff and included short-term debt in the capital structure. The Order concluded that the record demonstrated that MEC was using short-term debt as a permanent source of capital and that having low or zero balances during the test year and consistent annual refinancing of short-term debt were insufficient reasons to exclude short-term debt from the capital structure. (Order, Docket No. 99-0534, July 11, 2000, p. 10) That Order further states that "the Commission requires that short-term debt to the extent it is used to finance assets included in rate base, be included in the capital structure. Just as it is necessary to properly match revenues and expenses in a test year, it is necessary to match assets included in rate base and the sources of capital used to finance those assets." (*Id.*, p. 11)

F. Nicor Gas' Rate Base Includes Short-Term Assets

Nicor Gas argues that Staff claims that the Company is investing the entire test-year average outstanding balance of short-term debt in long-term rate base assets. (See Co. IB on Rehearing, p. 18) Nicor Gas represents its rate base as "long-term" (*Id*.), but this is contradicted by the evidence. Staff has shown that Nicor Gas' rate base does not consist of solely long-term assets. Nicor Gas' rate base includes current assets such as accounts receivable, gas in storage, and materials and supplies. (Rehearing Ex. 5). By definition, current assets are not long-term. More importantly, the

Company's rate base contains assets with balances that exhibit a high degree of seasonal variation throughout the test year. Short-term debt provides a source of funds that closely tracks the variability of those seasonal, rate based assets. The data unambiguously demonstrate that the long-term components of Nicor Gas' capital structure cannot be the sole source of funding for the Company's rate base since long-term capital cannot satisfy the seasonal need for funds that the seasonal portion of Nicor Gas' rate base creates. Assets with a high degree of seasonal variation must be financed with a seasonal source of funding. Therefore, Nicor Gas must be financing rate base, in part, with short-term debt. (Staff Ex. 18.0C, pp. 6-8)

G. Summary

In summary, Nicor Gas commits the greater portion of its Initial Brief on Rehearing arguing that short-term debt should not be included in its rate base despite the fact that the issue on rehearing is how much of Nicor Gas' short-term debt should be included in rate base. The three arguments that Nicor Gas puts forward for lowering the balance of short-term debt - short-term debt is financing gas costs not in rate base, margin calls and CWC exclusively - are refuted by the evidence. The Commission should not alter its original finding on short-term debt.

III. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations regarding the inclusion of the balance of short-term debt in the Company's capital structure for ratemaking purposes.

July 15, 2009

Respectfully submitted,

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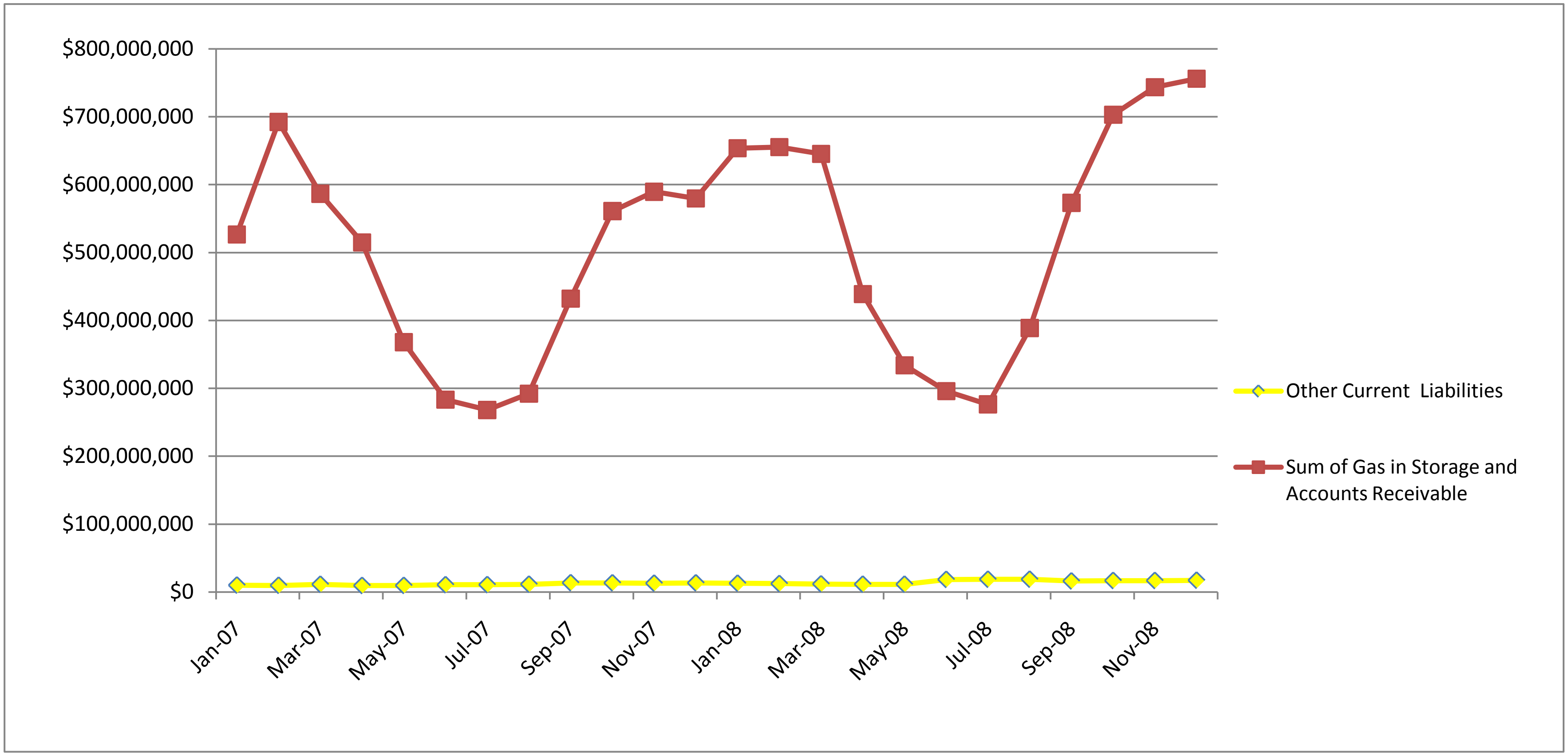
Nicor Gas Company

Capital Structure
Average 2009

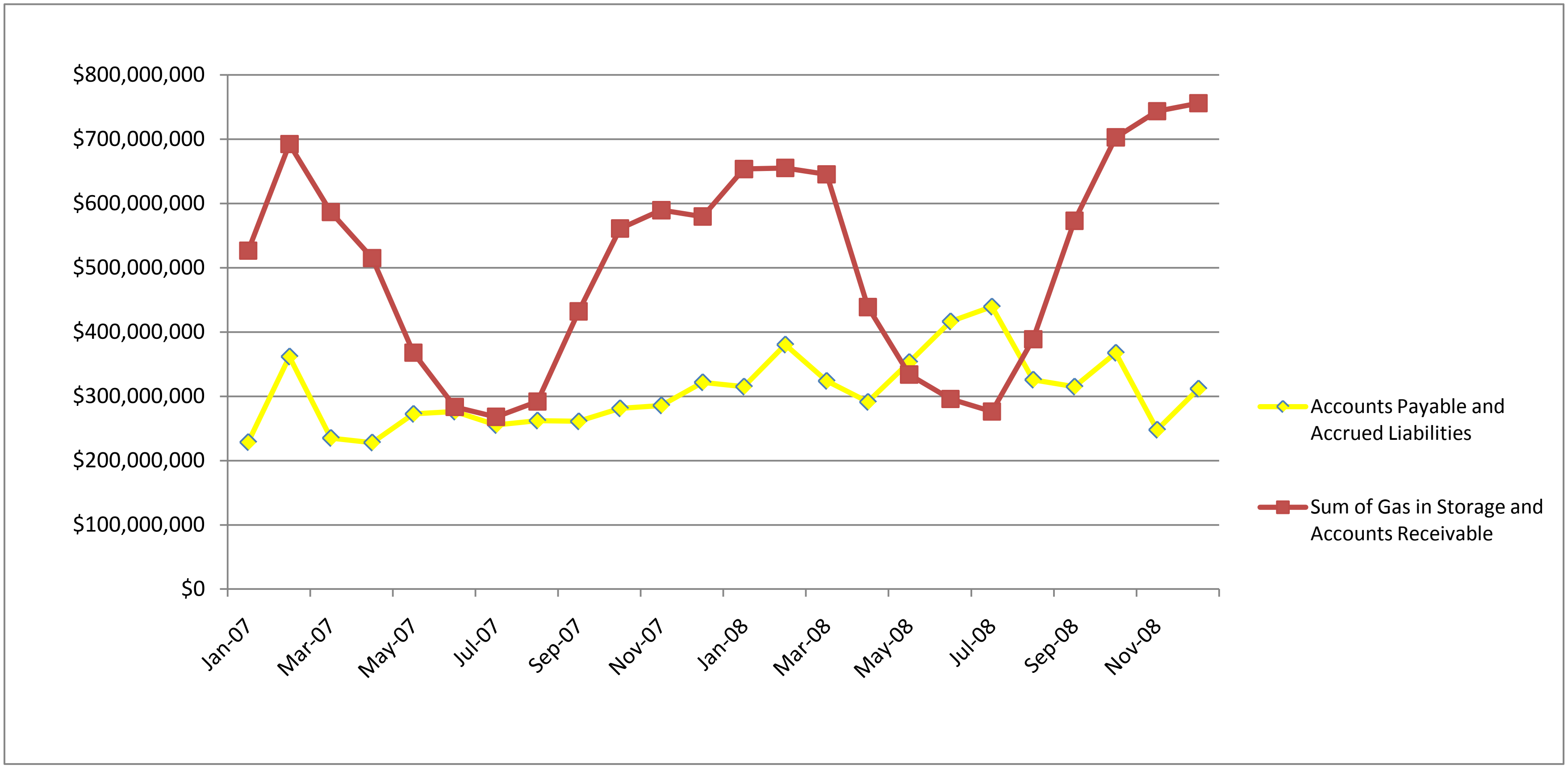
	Company Proposal		**Staff Proposal - Adopted in Final Order**		Nicor Gas Actual	
	Amount	Percent of Total Capital	Amount	Percent of Total Capital	Amount	Percent of Total Capital
Short-term Debt	$0	0.00%	$255,640,082	18.21%	$277,566,667	19.36%
Long-term Debt	$498,452,000	43.11%	$495,195,694	35.27%	$498,680,270	34.77%
Preferred Stock	$1,401,000	0.12%	$1,386,144	0.10%	$1,395,898	0.10%
Common Equity	$656,406,000	56.77%	$651,818,845	46.42%	$656,405,524	45.77%
Total Capital	$1,156,259,000	100.00%	$1,404,040,765	100.00%	$1,434,048,359	100.00%

Graph 1



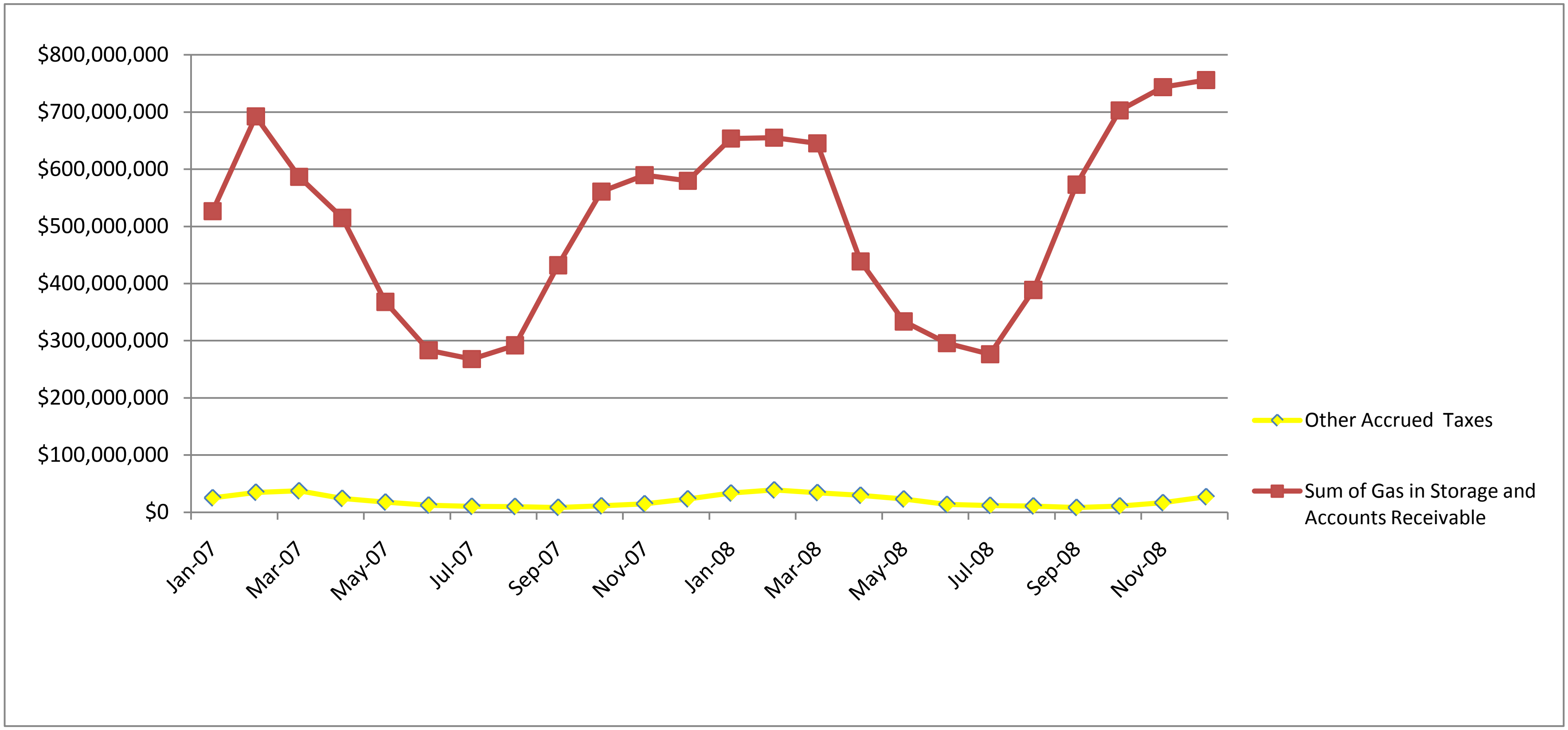
Sources: Other Current Liabilities - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 2



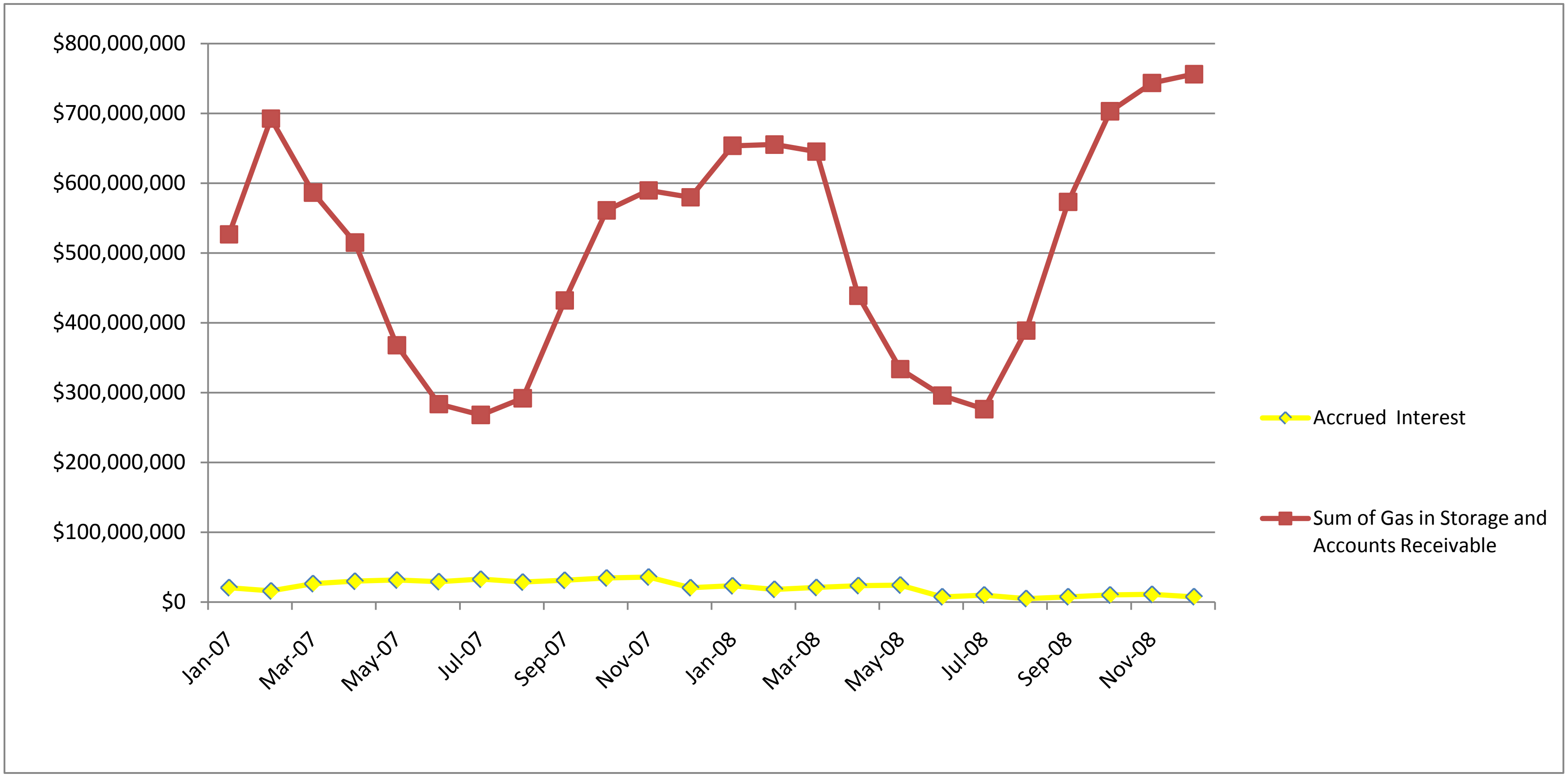
Sources: Accounts Payable and Accrued Liabilities - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 3



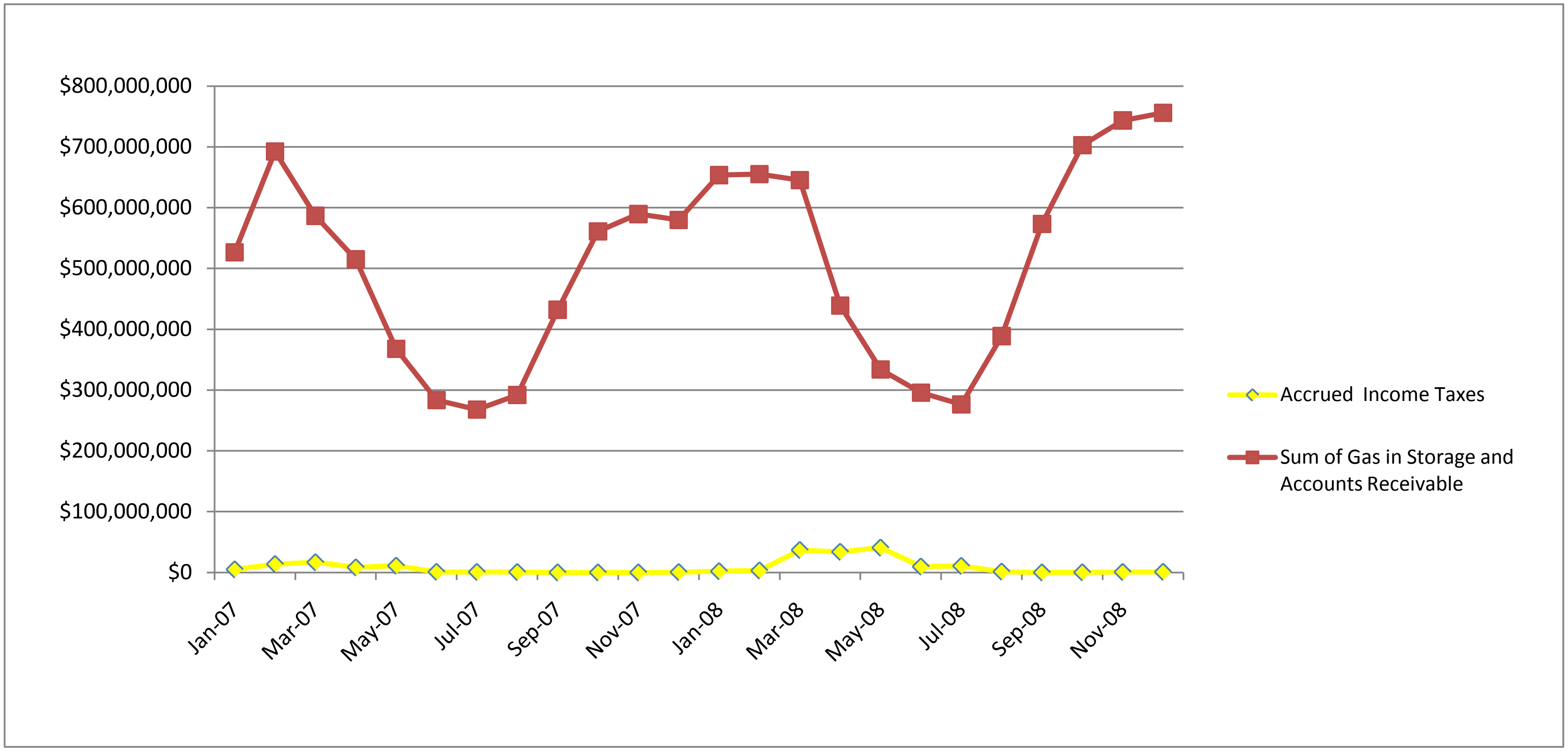
Sources: Other Accrued Taxes - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 4



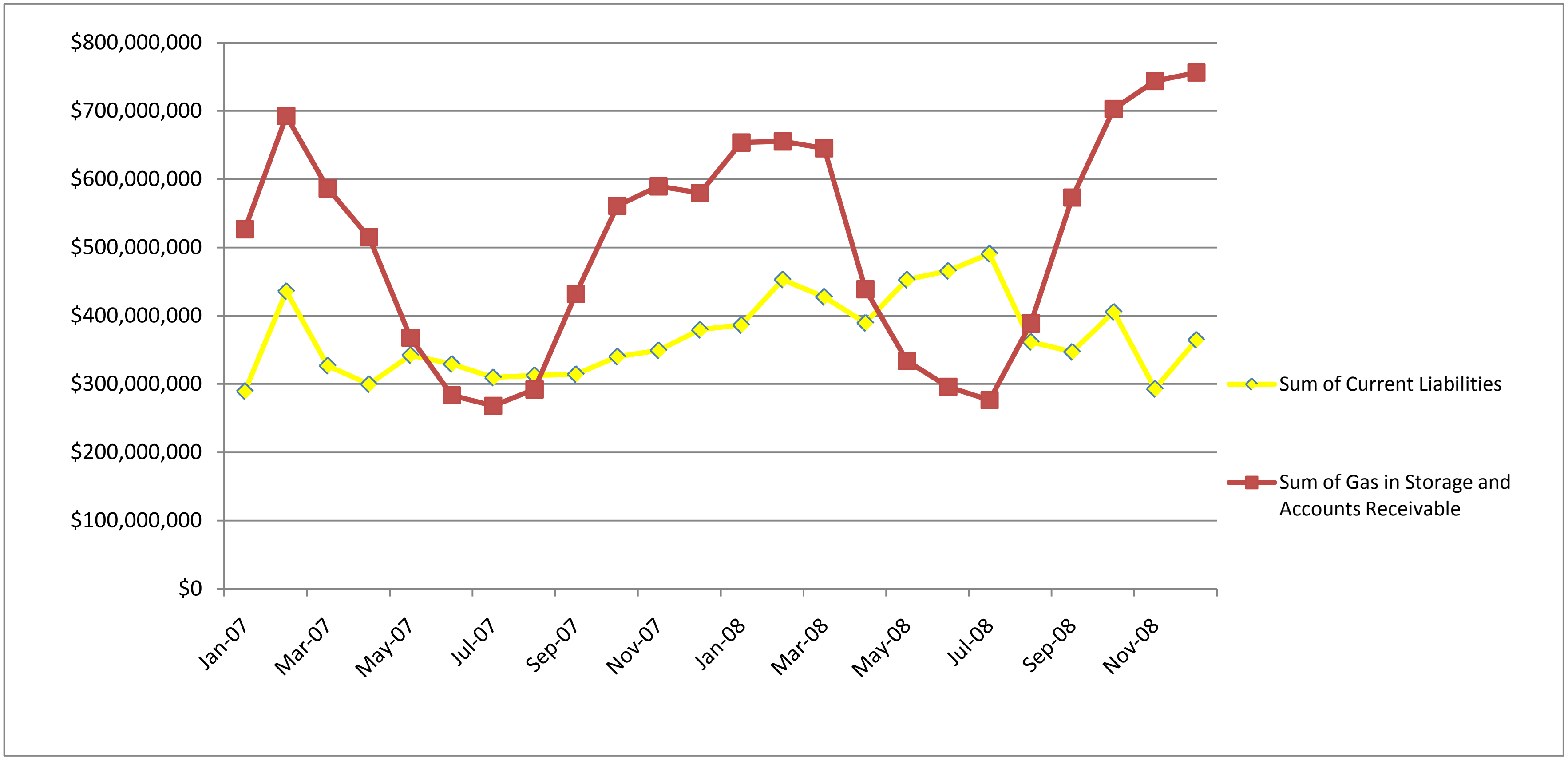
Sources: Accrued Interest - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 5



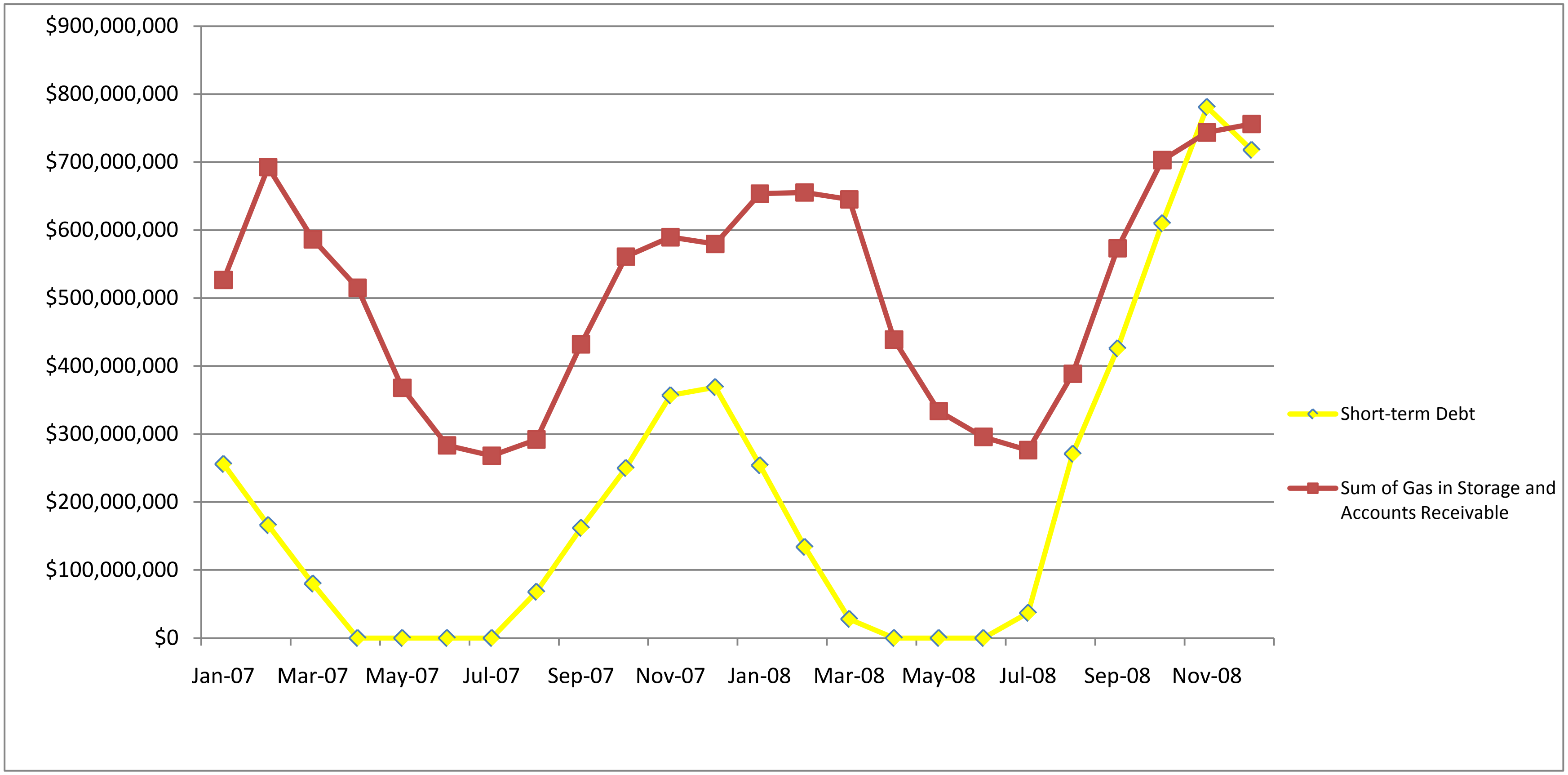
Sources: Accrued Income Taxes - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 6



Sources: Sum of Other Current Liabilities, Accounts Payable and Accrued Liabilities , Other Accrued Taxes , Accrued Interest and Accrued Income Taxes - Rehearing Ex. 5;
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04

Graph 7



Sources: Second Errata to Staff IB on Rehearing, p. 2.
Short-term Debt - Rehearing Ex. 7
Gas in storage - Rehearing Ex. 2; Accounts Receivable - Staff Group Cross Ex. 1 - JF 4.04