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

STAFF'S RESPONSE TO THE MOTION TO STRIKE

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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 the ruling of the Administrative Law Judges, respectfully submit their Response to the Motion to Strike.

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. On June 24, 2009, parties filed their Initial Briefs on

Rehearing and subsequently filed their Reply Briefs on Rehearing on July 15, 2009. On July 22, 2009, the Company filed a Motion to Strike ("Motion") asking the Commission to strike portions of Staff's Initial and Reply Briefs on Rehearing.

II. ARGUMENT

Staff's position on rehearing is entirely based on record evidence in this proceeding. In its Motion, the Company fails to recognize that additional evidence was stipulated to during the rehearing. Staff's position on rehearing is not different from the position it took in the original proceeding, but Staff relies upon the additional evidence on rehearing to refine and further explain its position. The information included in the additional evidence was provided by Nicor Gas in the form of data request responses.

A. Correlation Coefficient Analysis

Nicor Gas alleges that Staff's statistical correlations constitute improper expert opinion testimony. Correlation is a mathematical computation that Staff performed using data that is in the record of this proceeding. Correlation simply summarizes in one number what can be seen by presenting data in a graph. While more complex than simple arithmetic, the correlation coefficient can easily be computed using widespread spreadsheet software such as Excel. Obviously, an expert is not needed to assist the Commission to rank the correlation coefficients in terms of relative size. A grade school student could perform such a task. Nevertheless, the interpretation of correlation coefficients does require some expertise. Fortunately, Staff's expert testimony in this proceeding explains how to interpret relative correlation coefficients and is found in the record: "Correlation is a statistical technique that shows how strongly two variables, in this case, changes in working capital and changes in the balance of short-term debt, are related. The closer the correlation coefficient is to +1, the more positively correlated the two variables are." (Staff Ex. 5.0, p. 4, footnote 6) This statement from an expert informs the Commission that the higher the correlation, the stronger the positive relationship between the two variables. Thus, expert testimony informs the Commission that the sum of gas in storage and customer accounts receivable (hereafter "GIS/AR") is more strongly related to short-term debt (correlation coefficient 0.71) than that sum of GIS/AR is to the current liability accounts that contain the cash lead components of cash working capital (correlation coefficients range from -0.12 to 0.51). (See Staff RB on Rehearing, Table 1, p. 14)

Despite its claim that Staff's correlation analysis on rehearing is improper and not supported by testimony, the Company presents its own correlation analysis for the first time in its Reply Brief on Rehearing and provides an interpretation of what constitutes a "meaningful" correlation. (See Co. RB on Rehearing, pp. 3 and 14) The relative relationship of correlation coefficients was supported by expert witness testimony (See Staff Ex. 5.0, p. 4, footnote 6); however, whether a single correlation is meaningful was not. The record does not contain any testimony on whether a dividing line between "meaningful" correlation and "meaningless" exists, much less where such a dividing line occurs, if any. While Staff does not object to the Company presenting an alternative correlation coefficient based on record data, the Company goes beyond this. It states, "Generally, a correlation of less than 0.80 is not considered meaningful" (Co. RB on Rehearing, p. 14), which is not based on any document or expert testimony in the record and was not subject to cross-examination. This proclamation should be disregarded. It is ironic that Nicor Gas would move to strike portions of Staff's briefs, which are supported in evidence, when its own brief contains very similar conclusions which are not supported in evidence.[1]

The Company goes even further. It claims, "On the other hand, if one were to use Staff's own correlation analysis—but included actual seasonal non-rate base storage gas—the result is a highly correlated 0.91, supporting the conclusion that short-term debt is financing non-rate base assets." (*Id*., p. 14) No citations are provided because the monthly balances of "non-rate base storage gas" are not in the record. This 0.91 correlation coefficient is totally unsupported by the record and must be disregarded.

Staff's correlation analysis is proper to include in briefs. It is simply a mathematical computation done in an Excel spreadsheet. The correlation analysis was performed to summarize the relationship in data from the record and to illustrate the relationship between variables. Staff provided expert testimony on how to interpret the correlation analysis. (See Staff Ex. 5.0, p. 4, footnote 6)

Even if the Commission deems it expert testimony to perform and interpret correlation analysis, expertise is not required to see the relationship shown in the graphs that depict the balances of short-term debt, gas in storage, accounts receivable and the current liability accounts that contain the cash lead components of cash working capital. (See Staff RB on Rehearing, Appendix B)

Nicor Gas, however, also seeks to have the graphs presented in Staff's IB and RB on Rehearing stricken. The Company's argument in this regard is both hypocritical

[1] In support of the proclamation that "a correlation of less than .80 is not considered meaningful," the Company cites to an extra record source. (*Id*.) Nothing in the record supports an assumption that the opinion of the cited source on this is the governing or prevailing opinion and it certainly was not subject to cross-examination.

and flawed. The argument is hypocritical because the Company itself uses graphs presenting data from Commission Orders to present its arguments. (See, for example, Co. RB on Rehearing, p. 5) The argument is flawed because it is again based on the assertion that Staff's Briefs "… contain page-after-page of new and inadmissible expert opinion testimony…" (Motion, p. 2) The graphs are entirely based upon record evidence. They simply map the monthly balances that the Company agreed to stipulate into the record.

For example, Graph 7 in Appendix B to Staff's RB on Rehearing (p. 7) charts the monthly balances of short-term debt and the sum of gas in storage and accounts receivable. The short-term debt balances are from Rehearing Ex. 7. On Rehearing Ex. 7, the short-term debt balance is $256,000,000 for January 2007 and $166,000,000 for February 2007. Those balances are the first two points on the line for short-term debt in Graph 7. The gas in storage balances are from Rehearing Ex. 2 and the accounts receivable balances are from Staff Group Cross Ex. 1- JF 4.04. For January 2007, the gas in storage balance is $14,917,467 and the accounts receivable balance is $511,779,000. The sum of those balances for January 2007 is $526,696,467, which is the first point on the line for the sum of gas in storage and accounts receivable in Graph 7. For February 2007, the gas in storage balance is $7,999,287 and the accounts receivable balance is $684,413,000. The sum of those balances for February 2007 is $692,412,287, which is the second point on the line for the sum of gas in storage and accounts receivable in Graph 7. All of the monthly balances for 2007 and 2008 on those Exhibits are charted on Graph 7. The 2007 and 2008 balances for the current liability accounts that contain the components of cash working capital are from

Rehearing Ex. 5. The graphs simply and properly present the data from the record evidence in a format that illustrates the pattern of the balances over that two year period.

B. LIFO Accounting Discussion

Staff's discussion of Nicor Gas' use of last-in, first-out ("LIFO") accounting is based upon the Company's response to Staff data request JF 11.01, stipulated into evidence as Rehearing Exhibit 4. The discussion is responsive to the Company's claim that it will finance $337.2 million in 2009 gas costs that are outside rate base with sources that include short-term debt. (See Staff RB on Rehearing, p. 5, citing Co. IB on Rehearing, p. 16) As stated in Staff's RB on Rehearing, the Company does not provide support for the claim. In fact, as Staff argues in its RB on Rehearing, the hypothetical example provided by the Company in response to Staff data request JF 11.01 illustrates that the $337.2 million in 2009 gas costs that are outside rate base are financed by customer prepayments and thus cannot be financed with investor-supplied short-term debt.

The allegedly "entirely new analysis of Nicor Gas' use of [LIFO] accounting" (Co. RB on Rehearing, p. 3) which Staff presented in its RB on Rehearing is simply a discussion of the hypothetical provided by Nicor Gas and stipulated into evidence as Rehearing Exhibit 4. While the Company's statement that there is no basis in *testimony* for the analysis is true, there is a basis in *evidence*. The discussion is based entirely upon the Company's own verified response to a data request which was stipulated into evidence. (See Rehearing Ex. 4) Contrary to the Company's protests, the LIFO discussion is simply a reiteration of the Company's data request response, which is in evidence.

There is no "undisputed record evidence" which "demonstrates" that the Company uses short-term debt, in part, to fund the $337.2 million test year difference between the Gas in Storage asset ("GIS") and the actual gas costs. (See Motion, p. 3) The testimony cited for that proposition simply references the difference between GIS and actual gas costs and recognizes that the difference is not included in rate base. (See *Id*., citing Co. Ex. 43.0, p. 8, ll. 174-185) Staff does not take issue with the testimony. However, the Company's conclusion that short-term debt funds the difference is unsupported by the record.

The fact that customers advance the difference between the cost of gas used to serve customers and the cost of replacement gas is not an opinion advanced by Staff. This is unquestionably illustrated in Rehearing Exhibit 4, which was authored and verified by the Company. The following passage from Staff's RB on Rehearing:

> … 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…(Staff RB, pp. 6-7)

is simply a narrative of the hypothetical facts provided by the Company in Rehearing Exhibit 4. The Company's response to Staff data request JF 11.01 includes Exhibit 1 which includes:

Amounts for Illustrative purposes only

Example- Temporary LIFO Liquidation

1/1/08 B.B. Gas in Storage	70,000,000	
January Withdrawal		(20,000,000)
February Withdrawal		(25,000,000)
March Withdrawal	(5,000,000)	
April Injection		10,000,000
4/30/08 E.B. Gas In Storage		30,000,000
Historical LIFO Cost of Inventory	$	1.50
Estimated Annual Inventory Replacement Cost	$	8.00

Assumptions:
--1/1/08 Inventory level is expected to be restored by the end of the year.
--Estimated Annual Inventory Replacement Cost does not change from month-to-month
--Only one "layer" of inventory exists at the historical cost of $1.50.

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Debit	Credit	Calculation
1/31/08:		
Cost of Gas 160,000,000		20,000,000 X $8.00
Gas In Storage	30,000,000	20,000,000 X $1.50
Temporary LIFO Liquidation	130,000,000	20,000,000 X ($8.00 - $1.50)

* * * *

The Company itself stated:

> (a) Gas in Storage inventory is carried at cost on a LIFO basis. Inventory decrements occurring during interim periods that are expected to be restored prior to year-end are charged to cost of gas at the estimated annual replacement cost, and the difference between this cost and the actual LIFO layer cost is recorded on the balance sheet as a current temporary LIFO liquidation. (*Id*.)

Staff next applied the LIFO methodology illustrated in the Company's response to the Company's 2009 test year gas inventory. Nicor Gas estimated it would have annual gas costs of $432.8 million and its GIS component of rate base is valued at $95.6 million. (Co. Ex. 43, p. 8, ll. 176-185) As the Company stated, "[t]he difference of $337.2 million is accounted for and financed outside of rate base, and the Company earns no return on this temporary seasonal investment in storage inventory. (*Id*.) What the Company did not state, but what is illustrated in Rehearing Ex. 4, is that Nicor Gas excluded $337.2 million of its $432.8 million of gas costs from rate base because Nicor Gas' customers would prepay Nicor Gas $337.2 million in gas costs during 2009. That is, consistent with the Company's hypothetical example of Temporary LIFO Liquidation, its customers would advance Nicor Gas $337.2 million for the purchase of gas later in the year.

C. Exhibit 3 of Motion

The purpose of Exhibit 3 in the Company's Motion is a mystery. The Company states in its Motion:

> Exhibit 3 to this Motion to Strike explains why Nicor Gas believes Staff's new LIFO analysis is wrong. Again, Nicor Gas does not present Exhibit 3 in an attempt to introduce new testimony, but rather to elucidate why testimony regarding the Company's accounting practices constitutes an opinion that should properly by [sic] subject to questioning and impeachment. (Motion, p. 6)

The first paragraph of Exhibit 3 is an argument without an issue. It wrongly implies that Staff is arguing that "Temporary LIFO Liquidation" should be subtracted from rate base. Staff did not take that position during the initial phase of the rate case nor does Staff take that position now. Rather, Staff explained <u>why</u> a large portion of Nicor Gas' gas costs are excluded from rate base: customer-financed costs such as the gas costs in question are not included in rate base.

Staff has already addressed the arguments advanced in the second Paragraph of Exhibit 3 in Briefs and this Response. (Staff RB on Rehearing, pp. 5-9)

The third paragraph of Exhibit 3 discusses page 2 of the Exhibit. Nicor Gas argues, "The difference between cumulative GSC revenue and cumulative actual gas purchase costs is unequivocally accounted for outside of rate base, and must be temporarily financed each year with short-term debt." (Motion, Ex. 3, p. 1) How Nicor Gas arrives at this conclusion is unclear for several reasons. Most importantly, the data contained in Exhibit 3 are not in the record and Nicor Gas' explanation is inadequate to say the least. Staff has never seen the data in this Exhibit before. As such, Staff informally requested citations for the data from the Company. Instead of providing citations to the record for the data displayed in Exhibit 3, the Company provided documents, or perhaps workpapers, which are not a part of the record. These documents were never introduced in testimony, never produced as responses to data requests, and never produced as additional stipulated evidence as part of this rehearing. Staff is unaware of the source of or purpose of the documents, and they are in Adobe Acrobat format without the formulas intact.

Moreover, the data provided in Exhibit 3 appears to be based on accrual accounting rather than cash accounting. Therefore, the column entitled "Cumul. Cash Flow (Inc./Dec.)" is mislabeled since accruals fail to take into account the actual cash flows of the transactions.[2] Exhibit 3 is not supported by the record, is highly prejudicial,

[2] Companies raise capital to meet cash requirements, not accounting accruals. (Staff Ex. 18.0C,pp. 6-9)

and should be disregarded. It is the Company itself, not Staff, which is using evidence outside the record.

Finally, notwithstanding the fact that Exhibit 3 is derived from unexamined data from outside the record, and even if one assumes that the accrual data is a reasonable proxy for Nicor Gas' cash flows, Exhibit 3 supports Staff's, rather than the Company's, position on short-term debt in this rehearing. Column (c) of the Exhibit shows a build-up of "excess" gas charges to customers from January through April.[3] Just as Staff described in its RB on Rehearing, the Company repays those "excess" charges during the remainder of the year. (See Staff RB on Rehearing, p. 8) In fact, Column (e) shows that the average estimated $97,854,000 of short-term debt needed during 2009 to finance gas costs is far closer to the $95,645,000 gas in storage the Commission approved for inclusion in rate base in its March 25, 2009 rate order (See Order, Appendix A, p. 4) than to the $337 million in customer prepaid gas costs, which are not included in rate base. Thus, far from supporting the Company's argument that short-term debt is financing gas costs not in rate base, Exhibit 3 supports Staff's discussion regarding LIFO gas inventory accounting presented in its Reply Brief on Rehearing. Further, the Exhibit supports Staff's position that short-term debt is in fact financing gas in storage (i.e., gas costs in rate base).

III. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission deny the Company's Motion to Strike and that its Order reflect all of Staff's

[3] Exhibit 3 shows that during 2008, the Company forecasted that excess gas charges would peak at $586,334,000 in April; during 2009, the Company forecasted that excess gas charges would peak at $566,398,000 in April.

recommendations regarding the inclusion of the balance of short-term debt in the Company's capital structure for ratemaking purposes.

July 29, 2009

Respectfully submitted,

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VERIFICATION

I, Janis Freetly, being first duly sworn, depose and state that I am a Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Illinois Commerce Commission; that I have personal knowledge of the information stated in the foregoing Response to Motion to Strike; and that such information is true and correct to the best of my knowledge, information and belief.

Janis Freetly

Janis Freetly
Illinois Commerce Commission

Subscribed and sworn to before me
this 29th day of July, 2009.

Meri L Sanders

Notary Public

OFFICIAL SEAL
MERI L. SANDERS
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES 7-19-2011