

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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| 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 | : | |

Surrebuttal Testimony of

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Managing Director
Huron Consulting Group

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

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Identification of Witness**

3 Q. Please state your name.

4 A. My name is Alan Felsenthal.

5 Q. Are you the same Alan Felsenthal who submitted rebuttal testimony on behalf of
6 The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas
7 Company (“North Shore”) (together, the “Utilities”) in this proceeding?

8 A. Yes.

9 **B. Purpose of Surrebuttal Testimony**

10 Q. What is the purpose of your surrebuttal testimony?

11 A. My surrebuttal testimony addresses the respective rebuttal testimony of David
12 Effron submitted on behalf of the Illinois Attorney General’s Office and The
13 Citizens Utility Board (“AG/CUB”) and Bonita Pearce submitted on behalf of the
14 Illinois Commerce Commission (“Commission”) Staff (“Staff”). I specifically
15 address certain statements made by Ms. Pearce concerning the rate base treatment
16 of Peoples Gas’ prepaid pension asset and OPEB (other post-retirement benefits)
17 liability and North Shore’s accrued pension liability and OPEB liability.

18 **C. Summary of Conclusions**

19 Q. Please briefly summarize the conclusions of your surrebuttal testimony.

20 A. My surrebuttal testimony concludes that:

- 21 • The source of Peoples Gas’ prepaid pension asset is investors not
22 customers and, as such, should be included in rate base.
23 Customers pay for service. Debt and equity investors fund assets.
- 24 • Ms. Pearce’s position that Peoples Gas’ pension asset results in
25 part from the “timing” difference between contributions to the
26 pension plan and Financial Accounting Standards (“FAS”) 87
27 expense should not be a factor in determining the appropriate rate
28 base treatment for the pension asset. Many balance sheet accounts
29 are simply “timing differences” yet they are included in rate base.
- 30 • Contrary to Ms. Pearce’s position, implementation of FAS 158 did
31 not affect Peoples Gas’ prepaid pension asset. The additional
32 pension liability and pension related regulatory asset recorded as a
33 result of FAS 158 offset one another.
- 34 • Ms. Pearce’s position that North Shore’s accrued pension liability
35 should be deducted from rate base while Peoples Gas’ prepaid
36 pension asset should not be included in rate base is an
37 unsupportable inconsistency and is directly opposite the conclusion
38 she reached in the last rate cases for Peoples Gas and North Shore.
- 39 • Contrary to Ms. Pearce’s testimony, there is no requirement to
40 “track” amounts included in previous rate cases when determining
41 balances to be included or deducted from rate base and, generally,

42 the source of amounts included or deducted from rate base is the
43 amount taken from the balance sheet for the test period.

44 **II. THE PREPAID PENSION ASSET IS FUNDED BY INVESTORS**

45 Q. What is Ms. Pearce's position regarding the inclusion of Peoples Gas' prepaid
46 pension asset in rate base?

47 A. Ms. Pearce believes that the prepaid pension asset should not be included in rate
48 base because it is a timing difference and customers are the funding source for
49 this asset.

50 Q. Should the fact that a balance sheet item is a timing difference affect whether an
51 item is included in rate base?

52 A. No. Rate base is computed with many items that are timing differences. Deferred
53 taxes result from timing differences, yet they are deducted from rate base. Net
54 plant is the result of when capital assets are paid for and their allocation to
55 expense. The OPEB liability, which Staff proposes to deduct from rate base is a
56 timing difference. The fact that an asset or liability is related to a timing
57 difference is irrelevant.

58 Further, Ms. Pearce's position is at odds with the Commission's Order on
59 Rehearing in Docket No. 05-0597 involving Commonwealth Edison Company,
60 where a debt return on the prepaid pension asset was permitted. Under Ms.
61 Pearce's argument, the fact that a contribution was made to the pension plan
62 causing a pension asset would simply be "timing" and a return should not have
63 been allowed.

64 Q. Is Ms. Pearce correct when she states that that (1) the prepaid pension asset is not
65 funded by investors and (2) customers, by paying rates which include a test year
66 pension expense, are the source of the prepaid pension asset?

67 A. No. If one looks at the balance sheet, one sees liabilities, debt, and shareholders'
68 equity. With minimal exceptions (such as with advances or contributions in aid of
69 construction), one does not see a category of "ratepayer supplied funds."

70 Q. Why not?

71 A. Because customers buy natural gas service, they do not supply funds. This is not
72 just my position. The United States Supreme Court recognized this. In *Board of*
73 *Public Utility Commissioners et al. v. New York Telephone Company* (271 U.S.
74 23; 46 S. Ct. 363; 70 L. Ed. 808; 1926 U.S.), there is this conclusion:

75 Customers pay for service, not for the property used to render it. Their
76 payments are not contributions to depreciation or other operating
77 expenses, or to capital of the company. By paying bills for service they do
78 not acquire any interest, legal or equitable, in the property used for their
79 convenience or in the funds of the company. Property paid for out of
80 moneys received for service belongs to the company, just as does that
81 purchased out of proceeds of its bonds and stock.

82 The case makes it clear that shareholders, not customers, invest in utility assets,
83 some of which are financed with liabilities. If an asset is used and useful in the
84 operation of the utility, it should be included in rate base. In the case of Peoples
85 Gas' prepaid pension asset, the amounts have been incurred prudently and such

86 asset is used and useful in the provision of service to customers. As a result,
87 investors are entitled to a return on this asset.

88 Q. In Ms. Pearce’s rebuttal testimony she indicates that the People Gas net pension
89 asset was not created through negative pension expense. Is that correct?

90 A. No. Ms. Pearce appears to be basing her assertion on a data request response
91 which, responding to a request asking only about the last five years, indicates that
92 for the last five years there has not been negative pension expense. The table
93 below shows that you need to go back additional years to show the negative
94 pension expense recorded by Peoples Gas. In fact, for the years 1996 through
95 2003 Peoples Gas’ negative pension expense totaled \$174.3 million.

| Year | Pension Expense (millions) | Year | Pension Expense (millions) |
|------|----------------------------|-----------------|----------------------------|
| 1996 | \$(9.0) | 2000 | \$(37.3) |
| 1997 | \$(26.8) | 2001 | \$(21.9) |
| 1998 | \$(28.2) | 2002 | \$(25.0) |
| 1999 | \$(21.9) | 2003 | \$(4.2) |
| | | Total 1996-2003 | \$(174.3) |

96

97 Q. Do you agree with Ms. Pearce’s statement in her rebuttal testimony that:
98 “Accordingly, the net pension asset that the Company seeks to recover in rate
99 base is largely a function of accounting rules according to FAS 158, not a result of
100 excess contributions. It is also worth noting that the description regulatory asset
101 is used to denote timing differences that will be collected from ratepayers.” (Staff
102 Ex. 16.0 at lines 247-251)?

103 A. No, contrary to Ms. Pearce’s statement, the prepaid pension asset upon which the
104 Peoples Gas is seeking a return is exactly the level of the pension asset that would

105 exist on a FAS 87 basis (without implementation of FAS 158), which is
106 \$152.5 million (see NS-PGL Ex. CMP-1.3). FAS 158 required the funded status,
107 which is a liability of \$70.9 million (see NS-PGL Ex. CMP-1.3), to be put on the
108 books as a liability. The unrecognized actuarial losses and prior service costs
109 under FAS 158 are recorded as a regulatory asset. Under FAS 87 these items
110 were each components of the prepaid pension asset. Ms. Pearce is mistaken, the
111 net amount of prepaid pension asset being requested by PGL is unaffected by
112 FAS 158.

113 **III. STAFF'S INCONSISTENT TREATMENT OF PEOPLES**
114 **GAS' PREPAID PENSION ASSET AND NORTH**
115 **SHORE'S ACCRUED PENSION LIABILITY**

116 Q. In Ms. Pearce's rebuttal testimony (Staff Ex. 16.0) at lines 351 through 366, she
117 seeks to explain the treatment of North Shore's pension liability in the last rate
118 case. She states, "Therefore, my response (in the last rate case) was primarily
119 focused on Peoples Gas pension asset, rather than the North Shore pension
120 liability. In the instant proceeding, I have focused on both the pension asset
121 reflected by Peoples Gas and on the pension liability reflected by North Shore and
122 I have included my rationale for this treatment." How do you respond?

123 A. Ms. Pearce's response suggests that North Shore's pension liability was not
124 deducted from rate base in the last rate case because it was not a primary issue of
125 focus. This response appears to be contradicted by her rebuttal testimony in that
126 case where she specifically addressed the issue as follows:

127 The pension asset of Peoples and the pension liability of North Shore do
128 not represent elements of rate base that should impact the return to

129 shareholders. That is because the respective asset/liability was not created
130 with funds supplied by shareholders. Because these amounts were not
131 provided by shareholders, shareholders should not need to earn a return on
132 such amounts.

133 (ICC Docket Nos. 07-0241 / 0242 (Cons.), Staff Ex.14.0 at lines 490-95) Thus, it
134 appears that the issue was addressed by Ms. Pearce in the last proceeding and she
135 concluded that the prepaid pension asset and accrued pension liability should be
136 handled consistently, a position that she is deviating from in the instant case.

137 Q. Do you agree that there should be consistent treatment of the prepaid pension
138 asset and the accrued pension liability?

139 A. Yes, as I stated in my rebuttal testimony, the prepaid pension asset and the
140 accrued pension liability as well as OPEBs are similar in nature (both pensions
141 and OPEBs represent postretirement obligations of the entity) and the accounting
142 is similar (accrual accounting based primarily on the requirements of FAS 87 and
143 FAS 106) and, thus, both pensions and OPEBs should be treated consistently in
144 the rate case.

145 Staff has taken the position that there should be different (inconsistent)
146 treatment for pensions and OPEBs. I am simply suggesting that, at a minimum,
147 the pension accounts should be treated consistently. While my position is that
148 both Peoples Gas' prepaid pension asset and North Shore's accrued pension
149 liability should be considered in the rate base calculation, once Staff concludes
150 that the prepaid pension asset is to be excluded from rate base, it would be
151 inconsistent (and contrary to Staff's position in ICC Docket Nos. 07-0241/0242

152 (Cons.) to require an adjustment to reduce rate base for the accrued pension
153 liability.

154 I should point out again that AG/CUB witness David Effron disagrees
155 with Ms. Pearce on this issue and has not reduced North Shore's rate base for the
156 accrued pension liability.

157 **IV. STAFF'S INCONSISTENT TREATMENT TO OBTAIN THE**
158 **UNDERLYING AMOUNT OF THE PREPAID**
159 **PENSION ASSET AND THE OPEB LIABILITY**

160 Q. Ms. Pearce recommends in her rebuttal testimony that the OPEB liability should
161 be deducted from rate base. Where did the amount of the OPEB liability that Ms.
162 Pearce is deducting from rate base come from?

163 A. The amount of the OPEB liability that Staff deducts from rate base in this
164 proceeding is the amount reflected on Peoples Gas' and North Shore's balance
165 sheet and is the average balance for the projected test period ending December 31,
166 2010. As Ms. Pearce states in her rebuttal testimony, "The accrued liability
167 represents the aggregate OPEB costs recognized in the income statement which
168 has not been paid to a third party." (ICC Staff Ex. 16.0 at lines 374-376)

169 Q. Was any attempt made by Ms. Pearce to compare the amounts of the OPEB costs
170 included in previous rate cases to determine the amount that of OPEB costs that
171 customers have paid through rates?

172 A Not in her testimony.

173 Q. Is this the same approach used by Ms. Pearce in her analysis of the source of the
174 prepaid pension asset?

175 A. No. For Peoples Gas' pension asset and for that asset only, Ms. Pearce's position
176 is that none of the prepaid pension asset reflected on Peoples Gas' balance sheet
177 (and included in rate base) can be directly correlated to the prior rate case
178 treatment of pension expense and, as a result, she adjusts rate base to remove the
179 pension asset. She ignores the recording of negative pension expense in Peoples
180 Gas' income statements which give rise to the prepaid pension asset, as well as
181 contributions to the pension fund, which also impact the prepaid pension asset.

182 In one case, the prepaid pension asset, Staff wants to trace funds from
183 prior rate case test periods to conclude that ratepayers paid for the pension asset
184 recorded on the balance sheet at the end of the test period. In the other case,
185 OPEBs, the Staff is not concerned with such rate case tracing and is content with
186 simply using the amount recorded on the balance sheet through charges reflected
187 on income statements whether or not such income statements were used as a test
188 year. To be consistent, Ms. Pearce would sum the OPEB expenses permitted in
189 prior rate cases and use that total as the "ratepayer provided" rate base deduction
190 for OPEBs.

191 Q. Can you further comment on this point?

192 A. Yes. As I indicated in my rebuttal testimony and have previously stated in this
193 surrebuttal testimony, customers pay for service, not individual expenses (unless
194 broken out into separate charges or fees). The test year is used to establish the
195 overall cost of service and there is no requirement to "track" the amounts paid in
196 individual customer billings and allocate portions of each bill to payments for
197 maintenance, pensions, OPEBs, depreciation, etc. This is not necessary nor is it

198 practical. Peoples Gas and North Shore derive the OPEB balance from their
199 projected balance sheet, which is based on actual balances recorded on the books
200 adjusted for forecast changes through year-end 2010. As stated above, Ms. Pearce
201 accepts these amounts for OPEBs (and other rate base components) based on
202 “costs recognized in the income statement,” (Staff Ex. 16.0, line 375) and only
203 singles out the prepaid pension asset for special treatment.

204 **V. COMMONWEALTH EDISON COMPANY’S ORDER ON REHEARING**

205 Q. On page 5 of Mr. Effron’s rebuttal testimony, referring to the Order on Rehearing
206 in Commonwealth Edison Company’s 2005 rate case clarifies that in that case,
207 Commonwealth Edison Company was permitted a debt return on the pension
208 contribution. He makes the following statement:

209 The \$803 million pension contribution was not actually included in rate
210 base. Rather, the Commission allowed a debt return on the pension
211 contribution in pro forma operation and maintenance expenses in Docket
212 05-0597.

213 (AG/CUB Ex. 4.0). Is he correct?

214 A. Yes. As I said on page 26 of my rebuttal testimony, “A return based on what
215 would have been the utility’s long term debt rate, if it had financed the
216 contribution, was allowed on this pension contribution in the rehearing order.”

217 Q. Does the conclusion expressed in the rehearing order have implications to Peoples
218 Gas and North Shore?

219 A. Yes. First, it demonstrates that the Commission has previously permitted a return
220 on a prepaid pension asset. A potential conclusion is that to obtain a return on
221 pension contributions in Illinois, rate regulated companies such as Peoples Gas and

222 North Shore need to obtain debt or equity financing specifically linked to the
223 pension contributions being made. As I stated previously in my rebuttal and
224 surrebuttal testimony, this is normally not required as all assets are funded by debt
225 and equity investors. Customers are paying for service.

226 Q. Does this complete your surrebuttal testimony?

227 A. Yes.