

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

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

Surrebuttal Testimony of

**JAMES F. SCHOTT**

Vice President, Regulatory Affairs

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

August 17, 2009

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1 **I. INTRODUCTION AND PURPOSE**

2 **A. Witness Identification**

3 Q. Please state your name.

4 A. James F. Schott.

5 Q. Are you the same James F. Schott who submitted direct testimony and rebuttal testimony  
6 on behalf of The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore  
7 Gas Company (“North Shore”) (together “the Utilities”) in this consolidated Docket?

8 A. Yes.

9 **B. Purposes of Surrebuttal Testimony**

10 Q. What are the purposes of your surrebuttal testimony in this proceeding?

11 A. The purposes of my testimony are to:

- 12 1. identify the other witnesses providing surrebuttal testimony on behalf of the Utilities  
13 and briefly summarize the subjects on which they are testifying;
- 14 2. briefly overview respective positions in rebuttal testimony of the Illinois Commerce  
15 Commission’s (the “Commission” or “ICC”) Staff (“Staff”) and intervenors;
- 16 3. respond to the rebuttal testimony of Staff witness Dianna Hathhorn regarding costs  
17 associated with the Liberty pipeline audit; and
- 18 4. respond to the rebuttal testimony of “AG/CUB”<sup>1</sup> witness David Effron regarding the  
19 proposed infrastructure improvement rider, Rider ICR.

20 **C. Summary of Conclusions**

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

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<sup>1</sup> “AG/CUB” refers to the testimony jointly presented by the Illinois Attorney General’s Office (the “AG”) and the Citizens Utility Board (“CUB”).

22 A. In brief, the conclusions of my surrebuttal testimony are as follows: The overall revenue  
23 requirements recommended by Staff and AG/CUB remain very inadequate if the Utilities  
24 are going to continue to provide safe, adequate, and reliable gas distribution service over  
25 time.

26 Ms. Hathhorn's proposed adjustment relating to the Liberty pipeline audit remains  
27 improper.

28 Mr. Effron's proposal for a deferral mechanism in lieu of approval of Rider ICR  
29 would increase rate impacts in the Utilities' next rate cases. His proposed conditions for  
30 approval of such a mechanism as an alternative to the rider are unwarranted.

31 **D. Itemized Attachments to Surrebuttal Testimony**

32 Q. Are you sponsoring any attachments to your surrebuttal testimony?

33 A. Yes. I am sponsoring NS-PGL Ex. JFS-3.1, described below.

34 **II. IDENTIFICATION OF OTHER WITNESSES PROVIDING SURREBUTTAL**  
35 **TESTIMONY ON BEHALF OF PEOPLES GAS AND NORTH SHORE**

36 Q. Please identify the other witnesses presenting surrebuttal testimony on behalf of Peoples  
37 Gas and North Shore and the main topic(s) that each witness addresses.

38 A. In brief, the following other witnesses are providing surrebuttal testimony on behalf of  
39 Peoples Gas and North Shore on the following subjects:

- 40 • Christine M. Gregor, Director, Operations Accounting, Peoples Gas and North  
41 Shore (NS-PGL Ex. CMG-3.0), responds to the adjustments to the Utilities'  
42 proposed by Staff and intervenors in their respective rebuttal testimony, including  
43 adjustments that the Utilities accept in whole or in part, that involve updates in the  
44 cost of natural gas.

- 45           • Sharon Moy, Rate Case Consultant, Integrys Business Support (NS-PGL  
46           Ex. SM-3.0), responds to certain adjustments to the Utilities’ operating expenses  
47           proposed by Staff and intervenors in their respective rebuttal testimony, including  
48           adjustments that the Utilities accept in whole or in part, some of which involve  
49           updates in the cost of natural gas. Ms. Moy also provides the Utilities’ revised  
50           revenue deficiency (cost under-recovery) Schedules.
- 51           • James C. Hoover, Director – Compensation, Integrys Energy Group, Inc.  
52           (NS-PGL Ex. JCH-2.0), responds to Staff and AG/CUB rebuttal testimony  
53           proposing adjustments on the subjects of incentive compensation and non-union  
54           base wages.
- 55           • David W. Clabots, Manager, Sales and Revenue Forecasting, Integrys Business  
56           Support (NS-PGL Ex. DWC-3.0), responds to Staff and AG/CUB rebuttal  
57           testimony proposing adjustments to the Utilities’ sales forecasts.
- 58           • Paul R. Moul, Managing Consultant, P. Moul & Associates (NS-PGL  
59           Ex. PRM-3.0), responds to Staff and AG/CUB/City<sup>2</sup> rebuttal testimony on the  
60           subject of the Utilities’ costs of equity.
- 61           • Bradley A. Johnson, Treasurer, Peoples Gas and North Shore (NS-PGL  
62           Ex. BAJ-3.0), responds to Staff and AG/CUB/City rebuttal testimony on the  
63           subject of the Utilities’ costs of capital.
- 64           • Steven M. Fetter, President, Regulation UnFettered (NS-PGL Ex. SF-2.0),  
65           responds to Staff and AG/CUB/City rebuttal testimony on the subject of the  
66           Utilities’ costs of equity.

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<sup>2</sup> “AG/CUB/City” refers to the testimony jointly presented by the AG, CUB, and the City of Chicago.

- 67
- Edward Doerk, Vice President Gas Operations, Peoples Gas and North Shore  
68 (NS-PGL Ex. ED-3.0), responds to AG/CUB rebuttal testimony proposing  
69 adjustments to the Utilities' plant and Peoples Gas' employee headcount, Staff  
70 testimony regarding the rate of replacement of cast iron and ductile iron main in  
71 the Peoples Gas system, and Staff testimony proposing an adjustment related to  
72 the Liberty pipeline safety audit.
  - John Hengtgen, Rate Case Consultant, Integrys Business Support (NS-PGL  
73 Ex. JH-3.0), responds to Staff and AG/CUB rebuttal testimony on the subjects of  
74 Cash Working Capital, reserve for injuries and damages, Gas in Storage, cushion  
75 gas, and the Peoples Gas pension asset. He also provides the Utilities' revised  
76 rate base Schedules.
  - Thomas L. Puracchio, Manager Gas Storage, Integrys Business Support (NS-PGL  
77 Ex. TLP-3.0), responds to Staff rebuttal testimony relating to the Gathering  
78 System Modifications for Pigging and the Gathering System Pipe Replacement  
79 project.
  - Alan Felsenthal, Managing Director, Huron Consulting Group (NS-PGL  
80 Ex. AF-2.0), responds to Staff and AG/CUB rebuttal testimony regarding Peoples  
81 Gas' pension asset and North Shore's pension liability.
  - Valerie H. Grace, Manager, Gas Regulatory Services of Integrys Business  
82 Support (NS-PGL Ex. VG-3.0), responds to Staff and intervenor rebuttal  
83 testimony regarding rate design proposals, proposed tariff changes, and proposals  
84 related to the large volume and small volume customer transportation programs  
85 charges and tariffs.
- 86  
87  
88  
89

- 90
- Joylyn C. Hoffman Malueg, Rate Case Consultant, Integrys Business Support  
91 (NS-PGL Ex. JCHM-3.0), responds to Staff rebuttal testimony regarding the  
92 allocation of uncollectible accounts expenses and Staff and AG/CUB rebuttal  
93 testimony proposing adjustments to the Utilities' sales forecasts in terms of how  
94 those proposed adjustments relate to the embedded cost of service studies.
  - Salvatore D. Marano, P.E., Managing Director, Jacobs Utilities Practice (NS-PGL  
95 Ex. SDM-3.0), responds to Staff and intervenor rebuttal testimony, addressing  
96 Rider ICR, the absence of any need to conduct a further study of the proposed  
97 accelerated infrastructure replacement program or for additional independent  
98 consultant overview of the same, the implementation plan for the proposed  
99 accelerated infrastructure replacement program and the analysis of savings to be  
100 provided by the proposed accelerated infrastructure replacement program in the  
101 rebuttal testimony of AG/CUB witness Scott J. Rubin. Mr. Marano also responds  
102 to the Staff rebuttal testimony regarding the Gathering System Pipe Replacement  
103 project.
  - Richard Dobson, Manager of Gas Supply, Integrys Business Support (NS-PGL  
104 Ex. RD-2.0), responds to Staff and intervenor rebuttal testimony, addressing gas  
105 supply issues associated with the Utilities' large volume and small volume  
106 customer transportation programs.
  - John McKendry, Senior Leader of Gas Transportation Services, Integrys Business  
107 Support (NS-PGL Ex. JM-2.0), responds to Staff and intervenor rebuttal  
108 testimony, addressing various proposals to change processes related to the  
109  
110  
111

112 administration of the large volume and small volume customer transportation  
113 programs.

114 **III. STATUS OF THE CASES**

115 Q. In your rebuttal testimony you discussed whether the positions taken by Staff and  
116 intervenors enable the achievement of the objectives you had described for these  
117 consolidated rate cases. Do the positions they take in rebuttal enable the achievement of  
118 those objectives?

119 A. No, Staff and intervenors still propose revenue requirements that are very deficient if the  
120 Utilities are going to continue to provide safe, adequate, and reliable gas distribution  
121 service over time, but many of our differences have been eliminated or reduced. Peoples  
122 Gas and North Shore are pleased that, while some very significant issues remain, we have  
123 been able to resolve a great many of the issues raised by Staff and intervenors, as shown  
124 in NS-PGL Ex. JFS-3.1, which is an updated version of NS-PGL Ex. JFS-2.1 attached to  
125 my rebuttal testimony. We attribute this in part to the Utilities' prompt responses  
126 (14.5 days calendar average response time over the course of the cases to date) to the  
127 approximately 1,900 data requests received by the Utilities from Staff and intervenors in  
128 these cases.

129 **IV. RESPONSE TO STAFF REBUTTAL TESTIMONY**  
130 **ON COSTS AND THE LIBERTY AUDIT**

131 Q. In light of Staff witness Ms. Hathhorn's rebuttal testimony, do you continue to maintain  
132 that Staff's proposed Liberty audit-related adjustment is based entirely on a misreading of  
133 the Commission's Order in ICC Docket No. 06-0311?

134 A. Yes, I do.

135 Q. Did Ms. Hathhorn quote the standard to be applied from the Commission's Order in ICC  
136 Docket No. 06-0311 in her direct testimony?

137 A. Yes, she did.

138 Q. In defending her adjustment in her rebuttal testimony, did Ms. Hathhorn apply the  
139 standard outlined by the Commission in that Docket?

140 A. No, as in her direct testimony, she did not. The non-sequitur nature of her direct  
141 testimony, quoting the Docket and then applying a completely different standard, is  
142 striking and was not clarified by her rebuttal testimony. The non-sequitur was merely  
143 repeated and reinforced.

144 Q. In her rebuttal testimony, Ms. Hathhorn has claimed that she was quoted "out of context".  
145 Did you quote Ms. Hathhorn's direct testimony "out of context"?

146 A. No. The quotes I used are from the record in this proceeding, so the Commission has  
147 before it these quotes in context in the original testimony. I quoted relevant language to  
148 save time and space and to highlight the repetitive use of the Staff's new standard in lieu  
149 of the Commission's standard established in the prior Docket. When the Commission  
150 compares the entire testimony in this case and what was decided previously in ICC  
151 Docket No. 06-0311, I believe that it will be clear that Staff has created a new standard  
152 that did not exist in ICC Docket No. 06-0311.

153 Furthermore, Ms. Hathhorn's misreading in her direct testimony is compounded  
154 in her rebuttal testimony, where she states "If a utility violates applicable statutes or rules  
155 that result in that utility incurring more costs than it would have otherwise incurred  
156 without those violations, *even if those additional costs are to come into compliance*, then  
157 ratepayers should not bear the additional costs resulting from the utility's violations."

158 (Hathhorn Rebuttal, ICC Staff Ex. 15.0, lines 630-634, emphasis added). Again, that  
159 flies directly in the face of the Commission’s decision in ICC Docket No. 06-0311, where  
160 the Commission stated: “Peoples shall not seek recovery ...of costs or expenses ...and  
161 which are over and above the prudent and reasonable costs necessary to comply with the  
162 Act.” Paragraph VI (11), ICC Docket No. 06-0311.

163 Q. Did you review the testimony of Staff witness Darin Burk?

164 A. Yes, I did.

165 Q. Did his testimony alter your view that Staff’s proposed adjustment is improper?

166 A. No. Mr. Burk apparently believes that there were violations noted in the Liberty Audit,  
167 although they were not identified as such by Liberty. Again, Peoples Gas cannot be  
168 expected to maintain a tracking mechanism based on Staff’s retrospective view that  
169 violations existed. I also note that Mr. Burk quotes Ms. Hathhorn’s new standard on lines  
170 203 and 204 of his testimony: “plans and programs intended to bring Peoples Gas *into*  
171 *compliance with* the Liberty Report Recommendations” (emphasis added), rather than the  
172 Commission standard of “incremental costs caused solely by violation of ... the Illinois  
173 Gas Pipeline Safety Act (the “Act”) discovered by the Commission’s consultant ... and  
174 which are over and above the prudent and reasonable costs necessary to comply with the  
175 Act.”

176 **V. RESPONSE TO INTERVENOR REBUTTAL TESTIMONY**  
177 **ON INFRASTRUCTURE IMPROVEMENT RIDER (RIDER ICR)**

178 Q. Please comment on the deferral mechanism proposed as an alternative to Rider ICR in the  
179 rebuttal testimony of AG/CUB witness David Effron.

180 A. Mr. Efron has proposed a deferral mechanism in lieu of the Rider ICR proposed by  
181 Peoples Gas in this case. Peoples Gas believes that the Rider ICR is the appropriate  
182 method to recover such costs. The primary fault of a properly designed deferral is that it  
183 results in greater rate impacts to customers in the next Peoples Gas rate case, all else  
184 being equal. In the year of a rate case in which the utility would seek recovery of a  
185 deferral, rates would have to increase to recover the entire deferral plus the increase in the  
186 rate base and operating expenses from the last rate case. Not only would Rider ICR  
187 avoid the need for a deferral, but the build-up in rate base due to main replacement  
188 acceleration would be reflected in rates every year, spreading out the impact of the  
189 increase in rate base. Since it appears that all parties recognize the benefit of replacing  
190 the cast iron and ductile iron (“CI/DI”) mains, the Commission should consider which  
191 method best avoids an “all at once” rate impact of the main replacement acceleration  
192 costs.

193 Q. Do you have any further specific concerns with Mr. Efron’s deferral mechanism?

194 A. Mr. Efron proposes three conditions for the deferral mechanism on lines 258 through  
195 274 of his rebuttal testimony (AG-CUB Ex. 4.0). I will address each one in order. Please  
196 note that I am not addressing any legal issues. Any such issues will be addressed in  
197 briefing.

198 *Incremental costs.* Mr. Efron proposes that only the impact of incremental  
199 expenditures would be deferred. He provides a number of \$49 million as an estimate of  
200 replacements without any acceleration, but is unclear on what that covers. By way of  
201 background, the Rider ICR as proposed in this rate case was based on the Rider ICR from  
202 the previous rate case that had been modified to address issues raised by the Staff. One

203 of those modifications was to remove the incremental approach to be consistent with the  
204 rider mechanism used by water companies in Illinois. To be consistent both with  
205 Rider ICR as modified in the last case and the water companies' approach, and due to the  
206 lack of verifiable number on which to base the increment, the incremental approach  
207 should not be used.

208 *Return should be based on incremental cost of long term debt.* Costs associated  
209 with Rider ICR distribution assets are typical rate base items and should earn a weighted  
210 average cost of capital. Mr. Effron states that a "dollar-for-dollar recovery of the costs of  
211 the infrastructure replacement program is virtually guaranteed." To the contrary, the  
212 costs are merely deferred, in which case they can only be recovered as allowed in a future  
213 rate case. Once they are included in future rates, the recovery of the deferral still is  
214 subject to the same risks that Mr. Effron cites, namely "risks related to weather  
215 conditions, unexpected expenses, and numerous other factors." On the other hand, assets  
216 on which the utility earns a return have already been deemed prudent and are actually  
217 being recovered in rates. Therefore, assets that have not as yet been deemed prudent and  
218 which are not actually being recovered in rates currently are riskier than normal  
219 distributions assets. Accordingly, under Mr. Effron's logic, the assets subject to the  
220 deferral should earn a *higher* rate of return than normal distribution assets rather than the  
221 lower return Mr. Effron proposes.

222 *Deferral limited to actual under-earning.* Whether the utility is over or under-  
223 earning is dependent on a host of factors, including but not limited to, colder or warmer  
224 than normal weather, ability or inability to control costs and economic factors, most of  
225 which have no relation to the acceleration of infrastructure replacement. Therefore, tying

226 the recovery of such costs to whether the infrastructure costs could be deferred has no  
227 factual basis. For example, why should recovery of deferred infrastructure replacement  
228 costs not be allowed if colder than normal weather is driving higher sales and therefore  
229 higher net income, while it would be allowed if warmer than normal weather were  
230 lowering net income?

231 Q. Are there accounting issues associated with a deferral mechanism?

232 A. Yes. Under Generally Accepted Accounting Principles, specifically Financial  
233 Accounting Standards Board Statement No. 71, Paragraph 9, and Statement of Financial  
234 Accounting Standards No. 92, paragraph 8, an allowance for earnings cannot be deferred  
235 for financial accounting purposes. Such an allowance can only be recorded when the  
236 allowance is actually recovered in rates. The result will be depressed reported earnings  
237 for Peoples Gas until the deferral is recovered in rates.

238 Q. Have you reviewed the testimony of AG/CUB witness Scott J. Rubin and his financial  
239 model in AG/CUB Exhibit 6.05 in which he purports to determine the revenue  
240 requirement for expected capital expenditures set forth in Mr. Marano's testimony with  
241 respect to Peoples Gas' current main replacement program?

242 A. Yes.

243 Q. Does Mr. Rubin's analysis accurately portray how much ratepayers would pay if the main  
244 replacement program continues as-is without acceleration?

245 A. No it does not. Mr. Rubin's financial model assumes that absent Rider ICR, the cost of  
246 the Company's infrastructure investment immediately becomes part of its rate base. This  
247 would only occur after Peoples Gas filed and completed a rate case. Thus, Mr. Rubin's

248 model assumes annual rate cases being filed. Under that scenario, ratepayers ultimately  
249 would bear the administrative costs of each of those rate cases, which could exceed  
250 \$3 million each. Mr. Rubin's model fails to account for these additional costs to  
251 ratepayers.

252 Q. Is there anything further you would like to add about Rider ICR?

253 A. Yes. I would just like to point out that the Utility Workers of America, Local 18007, has  
254 come out in support of Peoples Gas' Rider ICR proposal and, by letter, has strongly urged  
255 the Commission to adopt Rider ICR.

256 Q. Does this conclude your surrebuttal testimony?

257 A. Yes.