STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	)	
Proposed general increase in natural gas rates.	)	09-0166
(Tariffs filed on February 25, 2009	)	
	)	Cons.
The Peoples Gas Light and Coke Company	)	
Proposed general increase in natural gas rates.	)	09-0167
(Tariffs filed on February 25, 2009)	)	

REPLY BRIEF OF THE PEOPLE OF THE STATE OF ILLINOIS

THE PEOPLE OF THE STATE OF ILLINOIS

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NOW COME the People of the State of Illinois ("the People"), by Lisa Madigan, Attorney General of the State of Illinois, and pursuant to the schedule established by the Administrative Law Judges, hereby file their Reply Brief on the issues discussed below in the above-captioned docket.

IV. RATE BASE

C. Plant

1. Forecasted Plant Additions

In its Brief, Peoples argues that its most recent forecast of plant additions, supplied to the parties in July, is the most accurate forecast of plant additions for the test year. PGL Brief at 33. The Company criticized Mr. Effron's decision not to adopt those new numbers in his rebuttal testimony. *Id.* at 34. As Mr. Effron explained, however, there already have been several changes to the forecasts of plant additions in 2009 and 2010. He stated that at the time he filed rebuttal testimony, he had no reason to believe that the 2009 and 2010 forecasts referenced by Mr. Doerk and Mr. Puracchio are any more accurate than the 2009 and 2010 forecasts in the responses to Staff Data Request MHE 12.01. Therefore, his schedules reflect the forecasts of plant additions in the responses to Staff Data Request MHE 12.01, and adjusted

the 2010 test year plant included in rate base in the rebuttal exhibits of Mr. Hentgen accordingly.

NS/PGL witness Doerk's surrebuttal statement that since the last update, revisions were made to the capital budget to reflect additions of "high priority public improvements and system improvements" never disclosed what these "high priority" projects were. There simply is no basis to hold the newest NS/PGL plant additions forecast more reliable than its second update to the original forecast.

Accordingly, Mr. Effron's proposed adjustments to plant additions, as reflected in AG/CUB/City Ex. 1.1, Schedule B-1 (North Shore) and AG/CUB/City Ex. 1.2, Schedule B-1 (PGL) should be adopted by the Commission.

H. Pension Asset(PGL)/Liability(NS) and OPEB Liabilities

Peoples argues in its Brief that the pension asset, the pension liability and the OPEB liabilities are all related in nature, and should be treated consistently. The Company opines that the Commission's decision to not allow the Company to include its pension asset in rate base prevents investors from earning a return on their investment and creates an incentive for Peoples to "make only the minimum required pension plan contribution, which results in greater risk to employees' pension benefits. PGL/NS Brief at 43. Citing the Second District Appellate Court's decision in the appeal of the 2005 ComEd rate case, in which the Court upheld the Commission's decision to exclude ComEd's pension asset from rate base but allow ComEd to recover at ComEd's cost of long-term debt an $803 million contribution to the pension plan, the Companies try to argue that the Appellate Court's decision supports the inclusion of the PLG/NS pension asset in rate base. PGL/NS Brief at 43, citing

Commonwealth Edison Co. v. Illinois Commerce Comm'n, Nos. 2-06-0184 Cons., Slip op. of September 17, 2009 at 17 (2nd Dist.). The Companies are wrong.

As Mr. Effron pointed out in his direct and rebuttal testimonies, the debt return on the $803 million pension contribution was included in the revenue requirement in the ComEd case. However, the other prepaid pension assets were excluded from rate base and there was no recognition of any return requirement on the other prepaid pension assets in the revenue requirement in Docket No. 05-0597. AG/CUB/City Ex. 2.0 at 5. Rather, the Commission allowed a debt return on the pension contribution in pro forma operation and maintenance expenses. He opined that it is important to note that it was established in that case that the $803 million pension contribution was specifically financed by the issuance of long-term debt. *Id.*

In addition, Mr. Effron explained that the Commission distinguished between the $803 million pension contribution specifically financed by the issuance of debt and other prepaid pension assets in that case. The debt return on the $803 million pension contribution was included in the revenue requirement. However, the other prepaid pension assets were excluded from rate base and there was no recognition of any return requirement on the other prepaid pension assets in the revenue requirement in that order. This treatment was continued in Docket No. 07-0566, Commonwealth Edison Company's next rate case. *Id.*

In the instant case, Mr. Effron updated his adjustment to the Retirement Benefits – Net based on the rebuttal testimony of Ms. Phillips and Mr. Hentgen in his own rebuttal testimony. *Id.* at 6. His calculation of rate base in Mr. Effron's rebuttal testimony reflects the updates addressed in the rebuttal testimony of Ms. Phillips and Mr. Hentgen, and should be incorporated in the revenue requirement for the Companies adopted by the Commission.

V. OPERATING EXPENSES

C. Contested Issues

1. Incentive Compensation

In its Brief, PGL/NS continue to argue, as they have in the last PGL/NS rate case, that the incentive compensation expenses disallowed by Mr. Effron are prudent and reasonable, and that they are necessary to "attract and retain a sufficient, qualified, and motivated work force… ." PGL/NS Brief at 56. The Companies argue that the alternative of moving more compensation to base pay would put them at a disadvantage in the labor market. *Id.*

The Company's arguments are entirely beside the point. No party contends that the incentive compensation results in excessive or unreasonable salaries. Rather, the issue is a matter of matching the costs and benefits of the programs, so that costs are borne by the beneficiaries. Aligning the cost with the benefit received has been the consistent metric applied by the Commission in the area of incentive compensation. Moreover, as noted in the AG Initial Brief, the aforementioned recent decision by the Second District Appellate Court supports Mr. Effron's view of how to treat incentive compensation in customer rates. In *Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 2-06-1284 Cons., Slip op. of September 17, 2009 (2nd Dist.), the Court rejected the company's argument that certain incentive plan costs benefited ratepayers in the sense that "attracting good employees raises the level of service customers will receive." *Id.* at 13. The Second District appellate court held that "(s)uch a benefit is too remote." *Id.*

When incentive compensation seeks to achieve goals that primarily benefit shareholders, then it is not unreasonable to require that shareholders bear the cost of that incentive compensation. To the extent that the incentive compensation results in higher earnings, then

shareholders should be more than willing to bear the costs of those programs. The Effron-recommended disallowances, itemized at page 12 of the AG Initial Brief, should be adopted.

2. Non-Union Base Wages (Agreed in Part)
3. Headcounts (Falls in Multiple Categories of L&M)

In their Brief, the PGL/NS opines that Peoples Gas submitted evidence in rebuttal that showed that they have hired new employees to respond to the Liberty audit that Mr. Effron's proposed adjustment to test year employee levels ignores. PGL/NS Brief at 63. The Companies also note that the Commission rejected Mr. Effron's proposed adjustment to employee numbers in the recent Nicor rate case. *Id.*

As noted in the AG Initial Brief, however, while the Company references the recent employees that have been hired, still no evidence was provided that any *net* increase in the employee complement resulted. As for the Commission's action in the 2009 Nicor rate case (ICC Docket No. 08-0363), this argument is not persuasive. The Commission must treat each case that comes before it based on the record evidence presented. 220 ILCS 5/10-103.

For all of the reasons cited above and as discussed in the AG Initial Brief (pp. 13-15), the Commission should adopt the proposed adjustment to employee numbers recommended by AG/CUB/City witness Effron.

8. Revenues

a. Sales Revenues Adjustment

PGL/NS list several reasons why Mr. Effron's proposed upward adjustments to North Shore and Peoples test year sales revenues should be rejected. First, the Companies opine that the forecasts are the "product of detailed, thorough forecasting methodologies" conducted by experienced forecasters. PGL/NS Brief at 73. Second, the Companies argue that Mr. Effron's

proposed adjustment, which is related to the forecasts' sensitivity to the projected cost of gas, "improperly selects one factor out of the sales models to update and ignores all other factors." *Id.* Third, the Companies point to the Commission's rejection of his sales revenues adjustment proposed in the 2008 Nicor rate case as evidence that his opinion should not be relied upon. *Id.* Finally, the Companies argue that the proposed adjustment would be offset by decoupling rider adjustments and increases in the Companies' uncollectible expense test year amounts. *Id.* at 74.

These arguments are strawmen, and should be rejected for several reasons. First, while it repeatedly asserts that other variables should be updated, not just factors related to the price of gas, the Company still has not quantified the supposed effect of updating the other variables that go into the sales forecast. Second, the last point cited – that uncollectible expense will need to be increased as a result of the adjustment – is factually incorrect. The increase to uncollectible accounts expense associated with the sales increase was, in fact, explicitly recognized (Schedule C-2, Note 5). The citation also mischaracterizes the testimony of the Companies' own witness, who did not state that the AG/CUB/City-proposed adjustment "overlooked" the effect on uncollectible accounts expense. NS/PGL Ex. CMB-3.0 at 7.

As noted in the AG Initial Brief, the current forecast of the 2010 price of gas is significantly lower than the projected prices at the time the sales forecasts were originally prepared. AG/CUB/City Ex. 1.0 at 14. Therefore, the sales forecasts should be modified to reflect the current forecast of 2010 gas prices. The Companies' assertion that other variables in the forecast need to be adjusted rings hollow when those adjustments are not quantified. To ignore the effect of the significant change in the price of gas for purposes of setting the test year sales forecast would result in ratepayers paying excessive rates. It should be noted, too,

that Staff witness Harden supported the concept of updating the forecast based on this variable. ICC Staff Ex. 24.0 at 18.

The Commission should adopt Mr. Effron's well-reasoned adjustment, as discussed at pages 17-18.

VIII. PROPOSED RIDER ICR

A. Peoples' Interpretation of Illinois Law Addressing Riders and Single-Issue Ratemaking is Wrong.

In their Brief, Peoples argues that there are no legal and regulatory barriers to Commission approval of Rider ICR. PGL Brief at 109. The Company cites the last Peoples Gas rate as precedent for the notion that the proposed Rider ICR meets the circumstances that are "lawful and reasonable." *Id.* Peoples asserts that the rider does not violate the rule against single-issue ratemaking because it provides "for the flowback of savings generated to customers." *Id.* at 110. This argument misses the mark and should be rejected for several reasons.

First, the $6,000 per mile savings estimate supplied by Mr. Marano, which the Company says cures the single-issue ratemaking problem, is just that – a forecasted estimate. It is a number that in no way guarantees the way traditional ratemaking guarantees that the actual changes in expenses and savings will be reflected in that estimate. The fact that the $6,000 figure can be revisited every few years, as the Company points out at page 113 of their Brief, is an admission that the number may not accurately flow savings back to customers and, at best, an acknowledgement that the savings estimate in no way replicates the balancing of overall expenses and revenues that occurs in test year ratemaking. *See Business & Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill.2d 175, 244 (1991).

But most importantly, the $6,000 savings per mile estimate does not address the core legal infirmity associated with the Rider ICR proposal: capital costs and depreciation expense

associated with new plant investment simply are not the kind of extraordinary expenses deemed appropriate by Illinois courts for rider recovery. The Commission highlighted this point in the 2008 rate order when it noted:

> Ultimately, Peoples Gas's arguments in support of Rider ICR detach from their legal moorings and become a policy plea. There is nothing about the costs that would be recovered under Rider ICR that are not the subject of routine, traditional Commission ratemaking.

2008 Peoples Order at 160. The instant Rider ICR proposal would recover expenses associated with financing main gas distribution infrastructure replacement from the first dollar of investment – expenses that are traditionally and appropriately recovered as a part of a rate case, where the revenue requirement can be recalibrated to reflect all of the changes in O&M expense that new plant investment triggers.

Peoples' summation of Illinois law on riders suggests that Commission authority to approve rider recovery of expenses is broad. PGL Brief at 111. In fact, it is circumscribed. As noted at pages 37-39 of the AG Initial Brief, capital and depreciation expenses associated with main replacement simply do not fit any of the legally recognized exceptions for rider treatment highlighted in both case law and the Public Utilities Act. *See* AG Initial Brief at 37-41. Quite the contrary, expenses associated with financing plant investment are the kind of normal recurring expenses that are the foundation of operating a natural gas distribution company and, more importantly, fail into that category of expenses that the Illinois Supreme Court specifically stated are not appropriate for rider recovery: expenses that would have "a direct impact on the utility's rate of return." *Citizens Utility Board v. Illinois Commerce Comm'n,* 166 Ill.2d 118, 137-138.

As such, Peoples application of Illinois law to its Rider ICR proposal should be rejected.

B. The Marano Cost Benefit Study Does Not Support Approval of Rider ICR.

Peoples cites the cost benefit study prepared by Mr. Marano as evidence that Rider ICR should be adopted. PGL Brief at 114-117. The Company also cites other benefits that acceleration and a medium pressure system would bring, in its effort to provide a response to the categories of information the Commission cited should, at a minimum, be provided in a future request for Rider ICR. *Id.* at 119-125. However, as noted in the AG Initial Brief, the Company confuses what they assert constitutes support for Rider ICR with evidence to support acceleration in general based on the time value of money. Staff witness Peter Lazare, in particular, highlighted this evidentiary defect, noting that the need for main replacement acceleration and how such a program should be funded are two distinct questions. ICC Staff Ex. 9.0 at 4. In fact, Mr. Marano's analysis never addressed how acceleration would be financed or the need for Rider ICR, and did not make any assumptions as to whether revenues to help finance the project came from base rate revenue increases or a rider. Tr. at 842-843. Likewise, as noted in the AG Initial Brief, neither Mr. Schott nor Ms. Grace provided a justification for rider treatment of future infrastructure investment. The Staff witnesses who examined the Rider ICR proposal also concluded that the Company had not proven its case.[1] Staff witness Lazare noted that "even if an accelerated program can be supported, that does not provide a compelling case for a rider mechanism." ICC Staff Ex. 9.0 at 5.

As for the cost benefit analysis itself, it too is flawed. As noted in the AG Initial Brief, the critical drivers in the Marano analysis, not surprisingly, relate to the assumptions made in his evaluation. First, he assumed that inflation would grow by 1.8 percent each year for the

[1] Section D of Peoples' Rider ICR section implies that Staff has signed off on the Company's proposed Rider ICR tariff. That simply is not the case. The Company never comments in its Brief on the fact that Staff opposes the proposed rider. Ms Hathhorn made clear that her proposed modifications to the ICR tariff were not to be interpreted as an endorsement of the rider request. ICC Staff Ex. 1.0 at 36.

next 49 years (the amount of time remaining in the current main replacement program). Tr. at 810. Second, he assumed that wages would increase each year for the next 49 years by 2.2 times the rate of inflation, or four percent. Tr. at 811. Based on those assumptions, Mr. Marano then concluded that the Company would save $432 million in construction costs over the 49–year period that encompasses the current acceleration rate. Of course, any variation in those assumptions will produce different results, as Mr. Marano admitted. Tr. at 812.

As noted by Mr. Rubin, in other words, the construction expenditure savings to which Mr. Marano refers at page 12 of his rebuttal testimony exist solely because of the underlying assumptions about materials and labor escalation costs. So, the longer an investment is delayed, the higher the cost will be under Mr. Marano's analysis, even after inflation (or the time-value of money) is factored out of the equation, as it is in PGL Ex. SDM-1.18. It should be noted, too, that PGL witness Edward Doerk, who oversees main replacement at Peoples Gas testified that the Company's union employees received a 3- or 3 ½-percent wage increase this past May. Tr. at 598-599. He also stated that labor cost are the "the biggest driver" affecting main replacement rates. Tr. at 600-601. Already, it would seem, Mr. Marano's cost benefit assumptions inflate annual savings estimates in his calculation of savings to be achieved by a 2029 acceleration date. (1.8 inflation x 2.2 = 3.96 percent assumed wage increase, as compared to the 3 to 3½ percent increase experienced this year.) While any cost benefit analysis assessment is driven by the assumptions used, the point that is clear is that the 2029 acceleration date recommended by Mr. Marano has no magic meaning or value. It certainly should not form the basis for any Commission conclusion that 1) a 2029 date must replacement completion date is appropriate, or 2) that Rider ICR is needed and appropriate.

One further point is worth noting. The Marano analysis in no way supported a conclusion that acceleration or Rider ICR is needed based on immediate safety concerns. During cross-examination, Mr. Marano confirmed that he did *not* attempt to identify, prioritize or evaluate the mains or the locations of the mains in the Company's CI/DI main system that have a 6.0 main ranking index or greater to determine which are the mains that should be retired. Tr. at 607, 808. This is an important point because the main ranking index or MRI is the methodology is used by the Company "in making appropriate decision about targeting which main to replace." PGL Ex. ED-1.0 at 12.[2] As it turns out, the amount of CI/DI main with a 6.0 MRI is low. During cross-examination, PGL witness Doerk stated that his recollection was that less than a mile of the 1,882 miles of CI/DI main remaining as of the end of 2008. Tr. at 597, 608. There simply is not evidence in the record to support adoption of Mr. Marano's recommended 2029 completion date or Rider ICR related to safety concerns.

The AG Initial Brief highlights other defects in the Company's case for Rider ICR approval. *See* AG Initial Brief at 20-27; 28-33. For example, the Company's own historical rate of main replacement investment further suggests Rider ICR simply is not needed. Between 1981 and 1993, the Company averaged replacement of about 77 miles per year *without* Rider ICR. Tr. at 617. The evidence also showed that Peoples regularly replaced more than 50 miles of CI/DI main during that time period without a rider cost recovery mechanism, with the Company installing more than 100 miles of new main in 1991. Staff Cross Ex. Doerk 20. Again, Rider ICR would permit Peoples to assess financing surcharges

[2] . The MRI system prioritizes main segments based on its maintenance history. According to Mr. Doerk, criteria taking into account include breaks, cracks at taps, pipe wall thickness based on pipe coupons, visual observation, incidence of leak and other repairs." PGL Ex. ED-1.0 at 12. All segments that have an accumulated MRI rating greater than 6.0 are placed on a schedule to be retired. *Id.* Mains with a ranking of 6.0 are the ones that are considered to be, either due to age or condition, most vulnerable to leaks. Tr. at 607.

for the first dollar of distribution investment spent. Such a mechanism has not been needed in the past and Peoples failed to show why it would be needed now.

In sum, the record evidence in no way supports adoption of Rider ICR based on the notion that it is needed to improve public safety or that benefits will accrue from acceleration in general.

C. Peoples' Criticisms of Mr. Rubin's Revenue Requirements Analysis Are Strawmen Arguments That Should be Rejected by the Commission.

At pages 117-119 of their Brief, Peoples makes several strawman arguments in an effort to 1) confuse the issue of what Mr. Marano's recommended 2029 acceleration plan would cost ratepayers, and 2) discredit Mr. Rubin's *undisputed* conclusion that the 2029 acceleration framework would cost ratepayers more than $3 billion more in revenue requirements through 2059, the date the current main replacement program is scheduled to end. Peoples first opines that Mr. Rubin's revenue requirement analysis does not accurately show what customers would pay under Rider ICR. PGL Brief at 117-118. This argument purposely rings hollow for a couple of reasons.

First, Mr. Rubin conducted his revenue requirement comparison *no*t to show what people would pay under Rider ICR (the amount people would pay depends on the rate of acceleration), but rather what the Company's revenue requirement would be if a 2029 completion date was adopted. Mr. Rubin's analysis – the only examination in the case of the revenue requirement implications of a 2029 completion date -- showed that the Company's accelerated program is significantly more expensive to customers – by more than $3 billion – than the continuation of Peoples' existing replacement program. AG/CUB Ex. 6.0 at 6. AG Brief at 34-36.

Contrary to the smoke and mirror arguments presented at pages 117-119 of their Brief, PGL witness James Schott confirmed in cross-examination that he did not dispute Mr. Rubin's comparison of the revenue requirements associated with the 2029 acceleration plan and the existing rate of replacement. When asked specifically about the analysis presented by Mr. Rubin, Mr. Schott indicated in his surrebuttal testimony and in cross-examination that the only calculation he took issue with was Mr. Rubin's failure to include about $3 million in rate case expense for each year of the period examined. Tr. at 69-70; NS/PGL Ex. JFS-3.0 at 11-12. As noted in the AG Initial Brief, even when that expense amount is incorporated into the analysis ($3 million x 49 years, or $147 million), Mr. Marano's preferred 2029 date ends up costing ratepayers in excess of $3 billion more than current main replacement practice. AG/CUB Ex. 6.06 at 6; *Compare* AG/CUB Ex. 6.05 with AG/CUB Ex. 6.06.

Peoples' second point – that, according to Ms. Grace, Mr. Rubin overestimated the amount to be paid under Rider ICR in the years 2011 through 2013, and that his revenue requirement analysis is "completely divorced from the reality of how Rider ICR would work" -- is another stawman argument designed to confuse the Commission. Again, the numbers shown in AG/CUB 6.06 attached to Mr. Rubin's rebuttal testimony calculate the annual revenue requirement associated with 1) the capital investment Mr. Marano used to develop the $432 million construction cost savings he refers to, as well as 2) the $159.7 million in capitalized O&M costs that would result from the 2029 acceleration that were omitted by Mr. Marano from his cost benefit analysis. AG/CUB 6.0 at 5. This exhibit is not meant to show what would be recovered under Rider ICR, but rather the annual *revenue requirements* that would be generated by a 2029 acceleration timeframe. The fact that the Company would not collect all of the annual revenue requirement amounts under Rider ICR, as highlighted by the

Company at page 118 of their Brief, only proves Mr. Rubin's point that regular rate cases would need to be filed by the Company to collect these increased expenditures. Mr. Rubin never stated these amounts would be recovered under Rider ICR. Rather, the analysis shows the impact of a 2029 acceleration deadline on customers from an annual revenue requirements perspective – not the impact of Rider ICR annually, as the Company asserts.

The next strawman argument comes at page 118, wherein the Company asserts that Mr. Rubin's revenue requirement analysis inappropriately limited his calculations to the 49-year time period when the current replacement program would end. PGL Brief at 118. The Company opines that Mr. Rubin agreed that revenue requirements on the construction cost amounts would continue for years into the future. *Id.* This, too, is a meaningless point. The fact is, in order to compare the revenue requirement needs of the two scenarios – a 2029 completion date or the current replacement rate which ends in 2059 – a beginning and ending time frame for the comparison must be selected. This was the appropriate timeframe to compare because Mr. Marano's cost benefit analysis examined this timeframe for purposes of quantifying the savings the Company would achieve if it accelerated main replacement to end in 2029 rather than 2059. The fact that revenue requirements continue into the future after 2059 is irrelevant to the meaningful revenue requirements comparison Mr. Rubin's Exhibits 6.05 and 6.06 provide.

Finally, the Company's statement that "Mr. Rubin was forced to admit on cross examination that if his analysis was carried out until the capital investments were completely depreciated, the current main replacement program would generate an overall larger revenue requirement than the accelerated main replacement program" is nothing more than silly, revisionist rhetoric. Mr. Rubin summarized on re-direct why such an exercise was

inappropriate for purposes of comparing the revenue requirement effects of the two acceleration scenarios. He noted that if someone attempted to examine the revenue requirement effects beyond 60 or 70 years for the plant that is being installed today, it would be inappropriate to assume that that plant simply depreciates down to zero and will not have to be replaced again. Tr. at 2012-2014. He continued by noting that "if you try to do (a) 100-year analysis, and say, well, what will the revenue requirement be, that analysis has to consider the fact that some of what you're installing today will have to be replaced again during that 100-year period. You can't just assume that it will become fully depreciated, deteriorate and there will be no new investment to take its place. So it (investment) becomes an ongoing process." Tr. at 102-1013. He explained that that problem of computing how the revenue requirement would be altered due to the need to restart investment is eliminated when the revenue requirements comparison is limited to the 50-year timeframe both he and Mr. Marano addressed. Tr. at 1014. The key difference between the two analyses was that Mr. Marano completely ignored any examination of the annual revenue requirements that would be required by the 2029 acceleration end date, unlike Mr. Rubin.

In sum, Peoples' rhetorical shell game tries to paint Mr. Rubin's examination of the revenue requirement effect of the Marano-recommended acceleration date as a defect and a misunderstanding of Rider ICR. These distortions should be ignored. No one other than Mr. Rubin – not Mr. Marano, Ms. Grace, Mr. Schott, Mr. Doerk or Staff witness Stoller – examined the practical ratemaking realities of a 2029 acceleration completion date. The Commission certainly is obligated to examine how the 2029 recommended acceleration completion date would affect customer rates, especially when that recommended timeline has nothing to do with public safety or actual replacement need. The Company's arguments

against such an examination only highlight what appears to be the primary driver for proposing Rider ICR: recovering financing costs for normal – not just accelerated – main and associated infrastructure replacement between rate cases. The Company has not proven a need for such an extraordinary illegal ratemaking mechanism. The request for Rider ICR should be denied.

D. The Marano-Recommended Completion Date Would Necessitate Nearly Annual Rate Increase Filings, Even With Rider ICR.

The Company opines that the net construction cost savings from accelerating the main replacement through a 2029 date are projected to be $272.3 million under the Marano cost benefit analysis. PGL Brief at 116. But, as pointed out in the AG Initial Brief, this number fails to consider how much customers would be required to pay in rates to support this capital investment. *See* AG Initial Brief at 32-33. Moreover, as noted at page 44 of the AG Initial Brief, a 2029 completion date for main replacement would put Peoples on a perennial rate case filing track, given the 5% cap included in the rider. Again, the Rider ICR tariff's so-called "cap" is calculated by multiplying 5% times the annual ICR base rate revenues. PGL Ex. VG-1.14 at 3 of 12. Thus, the amount of money that can be collected under the "cap" grows each time the Company files a rate case as the base rate revenues factor increases. As shown in Mr. Rubin's exhibit 6.06, a 2029 completion date would require near annual rate cases to recover the revenue requirements associated with the construction acceleration in order to reset the cap to accommodate the dollars spent. AG/CUB Ex. 6.06, pp. 1-3.

Given this reality, the question arises as to why the Company would need a rider in the first place. If Peoples is perennially filing rate cases to recover the revenue requirement associated with the Marano-recommended completion date *even with a rider,* then rates would reflect the costs of accelerated investment, assuming that investment is deemed prudent. The

issue of regulatory lag is non-existent. There simply is no need for a rider under these circumstances.

IX. STAFF PROPOSALS REGARDING ACCELERATION OF CAST AND DUCTILE IRON MAIN REPLACEMENT PROGRAM FOR PEOPLES GAS

A. The Instant Record Does Not Contain the Information Needed To Approve a Specific Plan for Acceleration.

In its Brief, Peoples rejects Staff witness Harry Stoller's recommendation that the Commission should order Peoples to conduct the accelerated main replacement program outlined in Mr. Marano's testimony. PGL Brief at 129. The Company notes that the record lacks evidence that immediate acceleration is necessary to prevent or eliminate a public safety concern. *Id.* at 130-131. The Commission Staff, in their Brief, posits that "Section 8-503 authorizes the Commission to require Peoples Gas to undertake an accelerated cast and ductile iron main replacement program, and provides authority for the Commission to adopt Mr. Stoller's recommendations to require Peoples Gas to undertake an accelerated program under the terms and conditions specified by Mr. Stoller … ." Staff Brief at 131. The People agree with both conclusions: the record does not indicate there is a public safety need to adopt the Marano-recommended acceleration completion date, and 2) the Commission has the authority to require the Company to undertake an accelerated program under Section 8-503. To be clear, there is no evidence, however, to support adoption of a 2030 completion date.

As noted in the AG Initial Brief, Mr. Stoller stated during cross-examination that he did not find any evidence in the present case that convinced him that Peoples' distribution system is not safe or not being operated safely at the present time. Tr. at 899. He also did not examine what the revenue requirement impact would be on both the Company and the ratepayers should a 2029 completion date be adopted by the Company. *See* ICC Staff Ex. 14.0

at 1-7. Rather, it appears that Mr. Stoller believes that "the system is old, it is antiquated, and it is approaching the point that further aging and deterioration will eventually cause replacement to maintain public safety to become an emergency matter rather than one which can be reasonably planned and executed." Staff Brief at 131.

The People concur that the Commission could order the Company under Section 8-503 to accelerate main replacement. Mr. Stoller recommends that the Company should be required to submit a specific implementation plan to the Commission that can be monitored on a regular basis. ICC Staff Ex. 14.0 at 2. Should the Commission determine that requiring acceleration was appropriate under Section 8-503, the People concur with Mr. Stoller that the Commission should order the Company to present a fully-developed plan for carrying out the program prepared by an independent consultant, with Commission oversight of the plan. However, any such plan must examine the revenue requirement impacts of specific acceleration plans and, given the lack of evidence of a need from a safety perspective of a 2029 completion date as well as Mr. Rubin's testimony about the ratemaking effects of the 2029 completion date, any plan adopted should extend beyond the Marano-recommended timeline.

B. Peoples' Surrebuttal Submission of a Guide to Main Replacement Acceleration is Inadequate to Ensure that Acceleration Occurs.

In its Brief, the Company argues that its "initial plan of action", submitted by Mr. Marano in the surrebuttal phase of the case, "demonstrates that Peoples Gas is capable of managing, implementing and executing an accelerated main replacement program in a reasonable and prudent manner without prior approval by (the) Commission." PGL Brief at 132. The People disagree.

Mr. Marano himself described the plan as "a guide." Tr. at 836. As noted in the AG Initial Brief, this plan of sorts in fact provides no detail as to when main replacement should occur, where the replacement should occur first in terms of safety and reliability and how it should be paid for in light of the substantial investment that would have to be undertaken to complete acceleration by Mr. Marano's recommended 2029 date. Tr. at 835-837; NS/PGL Ex. SDM-3.1.

It is worth repeating that Mr. Stoller's conclusion that main replacement acceleration is needed, and the Company's surrebuttal response to that directive, should not form the basis for approval of Mr. Marano's recommended 2029 timeline. As noted in the AG Initial Brief, the instant record does not contain the information, or indeed any substantive plan, needed to provide a basis for the Commission to make findings about what acceleration rate of CI/DI main is appropriate and which, if any, main locations should be prioritized for replacement within Peoples distribution system from public safety and reliability perspectives. Contrary to the Company's assertions (PGL Brief at 132), Mr. Marano's surrebuttal plan does not provide that essential information. Tr. at 837. Moreover, it is important to note that the Company refuses to commit to acceleration even with the adoption of Rider ICR. Tr. at 61; *See* AG Brief at 27.

As noted in the AG Initial Brief, if the Commission concludes that some sort of acceleration plan should be adopted based on Mr. Stoller's recommendation, the People urge the Commission to order the Company to first study the PGL main system so that mains with a high MRI receive priority replacement treatment. Development of an implementation plan should specify where main replacement is most needed from a safety and reliability perspective, a proposed timeline for replacement, evidence that the City of Chicago can work

with and keep pace with the necessary approvals that the Company will need for replacing and installing new main, and other important details. Just as importantly, the Company should include information about the revenue requirement effects of the plan on ratepayers and evidence that any implementation plan proposed will not trigger rate shock among Peoples' customer base. Finally, any plan should provide specific detail about employment needs for both union and non-union workers under any approved implementation schedule.[3]

To be clear, however, in no way does such a Commission finding support adoption of Rider ICR. The question of acceleration and rider recovery are two distinct issues. Peoples simply failed to justify rider recovery of main replacement financing costs is needed or appropriate under the law.

XII. RATE DESIGN

C. Service Classification Rate Design

1. Uncontested Issues

2. Contested Issues

a. North Shore/Peoples Gas Service Classification No. 1

i. Peoples and North Shore Do Not Present Principled Opposition to the Tiered Rate Structure Proposed by the Attorney General, City of Chicago and the Citizens Utility Board.

The Companies' brief alleges that "there are sound reasons why tiered rates have not been used for energy Companies," implying -- but not supporting the suggestion -- that tiered

[3] Local Union 18007 filed a brief on September 29, 2009 that concluded that acceleration of main replacement will increase the number of union, management and outside contractor jobs, and that therefore Rider ICR should be approved. Union Brief at 3. While the People agree that additional new jobs may be created through acceleration, approval of Rider ICR in and of itself will not ensure that acceleration will, in fact, occur. Also, AG Cross Exhibit 1demonstrated that the Company never conducted an analysis that compared the number of jobs for skilled workers with and without Rider ICR. Likewise, the Company's claim that jobs will be created ring hollow given the Company's objection to any specific commitment to accelerate main replacement or requirement to file a specific plan. (*See* AG Initial Brief at 27-28)

rates have been previously considered and rejected on their merits. PGL/NS Brief at 156. Peoples'/North Shore's brief then proceeds to describe the "conceptual flaws" inherent in AG/CUB/City witness Rubin's tiered rates proposal. But each and every one of the conceptual flaws listed by the Companies is, in fact, attributed not to the nature of the proposal or to solutions it proposes to address problems created by the Companies' rate design but rather to the data Mr. Rubin used in preparing his proposal. Nor does the brief's further reference to the "practical problems" of implementation confront the real problems created by the Companies' existing and proposed rate structure.

As AG/CUB/City pointed out in their Initial Brief, the Companies' current rate design, as well as their pending proposal, perpetuates billing disparities within customer groups, charging less to customers who impose greater burdens on the distribution system compared to customers whose usage patterns are less expensive to serve. By collecting most demand-related costs through the first consumption block, customers who use the most gas and cause the greatest residential demands are being subsidized by lower-use customers and customers who use gas efficiently throughout the year. Rubin's proposal addresses this inequity head-on, by collecting demand related charges through a flat customer charge linked to customer usage that will not penalize customers for using gas efficiently, as do the present and proposed rate structures.

What is most telling about the Companies' brief is that it shrinks from stating what is obvious: that it is necessary to address very serious cost-causation inequities in Peoples' and North Shore's rate structures. Because they do not deny the inherent problems in their rate design that Rubin so explicitly identifies and documents, the Companies cannot and do not challenge Rubin's assertion that their rate designs wind up collecting more money from

customers who cost less to serve Instead, Peoples and North Shore raise the strawman argument that Rubin's data renders his proposal "flawed." PGL/NS Brief at 156. Yet any flaws in the data set are only the result of the Companies' unwillingness to provide Rubin with the data he originally requested. Rubin asked for customer usage information from January 2006 through December 2008 for each company, but the Companies' indicated that they were able to provide this type of data only for a subset of customers (representing approximately two-thirds of all residential customers at each company) for a specific 12-month period. Nevertheless, Rubin's analysis is anything but perfunctory: it is based on actual billing data for approximately 531,000 Peoples residential customers and approximately 104,000 North Shore residential customers for the 12 months from July 2007 through June 2008.

The other category of criticisms the Companies' identify in Rubin's proposal are described as "practical," and do not provide a principled reason for ignoring the underlying defect in the existing and proposed rate structures which Rubin identifies. Any novel approach to rate design carries with it implementation issues, and in this case, they appear to be the sort that are easily enough addressed by the Companies' themselves: the proposal "includes only one set of rates" for both sales and transportation customers; it "would require substantial modifications to the Utilities' customer information systems"; it doesn't take into account the "transition period needed to develop, test and implement the modifications"; it would make revenue forecasting "complicated" and raise "novel issues" regarding tier placement. PGL/NS Brief at 157-158. All of these are technical issues, not policy dilemmas. Essentially, their opposition to a serious proposal to resolve persistent rate structure problems facing both the Companies and their customers is a weak one: "change is hard."

Moreover, implementation of tiered rates, because it does away with per therm distribution charges, addresses the issue identified by Staff as a source of conflict with the Companies' customer charge proposal. Staff indicates it cannot support the Companies' attempt to recover its fixed costs through the increased customer charge given the existence of Rider VBA. As Staff correctly points out, the rationale behind Rider VBA is the same as that presented to justify the customer charge increase: to better recover the Companies' fixed costs. Staff Brief at 160, 164. Instituting tiered rates addresses this problem directly: it establishes just one charge for fixed cost recovery and also eliminates the irrational price signals that decoupling sends to customers trying to conserve energy.

The Commission should reject the Companies' feeble arguments against tiered rates and tackle the rate design inequities that cause so many Peoples and North Shore customers to pay rates so unrelated to the distribution costs they generate.

WHEREFORE, the People of the State of Illinois urge the Commission to adopt the recommendations set forth in both this Brief and the People's Initial Brief, filed on September 29, 2009.

Respectfully submitted,

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