

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

**THE PEOPLES GAS LIGHT AND COKE COMPANY )  
Proposed general increase in ) Docket No. 09-0167  
Rates for Gas Service )**

**CITIZENS UTILITY BOARD'S BRIEF ON EXCEPTIONS ON THE ISSUE OF  
PEOPLES GAS LIGHT AND COKE COMPANY'S  
PROPOSED RIDER ICR**

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Pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (“Commission” or “ICC”), 83 Ill. Admin. Code 200.830, and the briefing schedule established by the Administrative Law Judges (“ALJs”), the CITIZENS UTILITY BOARD (“CUB”), by its attorney, submits its Brief on Exceptions on the issue of Peoples Gas Light & Coke Company’s (“Peoples,” “PGL” or the “Company”) proposed Rider ICR in this proceeding. For the reasons described in detail below, CUB requests the Commission modify the Proposed Order (“PO”) to deny “Infrastructure Cost Recovery” rider or “Rider ICR” in its entirety.

**I. INTRODUCTION**

CUB submits this brief separately from its Joint Brief on Exceptions with the City of Chicago (“City”) to address CUB’s exception to the Proposed Order’s conclusion to approve the Company’s proposed rate-tracking mechanism entitled Rider ICR. CUB urges the Commission to reverse the Proposed Order’s approval of Rider ICR, as it ignores the legal proscriptions against riders, lacks substantial evidence and is based on specious reasoning. CUB incorporates by reference the arguments made in its Initial Brief on the issue of Rider ICR, but will address below the broad legal and policy issues misapprehended by the Proposed Order in reaching the conclusion that Rider ICR is lawful and appropriate.

The Proposed Order misconstrues the issues presented for the Commission in approving Rider ICR. The PO appears to presume that the Company requested permission to implement a *program* to accelerate replacement of its existing case iron (“CI”) and ductile iron (“DI”) (together, “CI/DI”) mains and low-pressure system. This is not the case. The Company requested approval of *Rider ICR* to recover the costs associated with that program – not for the program itself – a position the Company itself makes clear.<sup>1</sup> This is a critical distinction. The fact is that the Company could implement an accelerated program without Rider ICR under traditional, lawful ratemaking standards, instead of through a piecemeal rider.

Peoples currently has a CI/DI main replacement program in place, a program that has successfully replaced more than 45% of Peoples’ CI/DI mains since 1981 without a rider. NS-PGL Ex. ED-2.0 at 5-6, LL. 110-112. In fact, the Company was able to perform these large infrastructure projects over a period of 12 years without even seeking rate relief<sup>2</sup>. Yet it now seeks to accelerate this replacement from the 50 year plan currently operating to a pace resulting in about half that time by requiring the replacement rate of 45 miles-per-year to more than double. Peoples Gas Ex. SDM-1.0 at 42. Mr. Rubin calculated the net effect of this accelerated infrastructure replacement to be an additional \$128.8 million in rates over the 19-year period of the proposed acceleration program, just looking at O&M expense. AG/CUB Ex. 6.0 at 3, LL. 41-42.

The Commission rejected the Company’s request for a similar rider in its last rate case, Docket 07-0242 as insufficiently supported. ICC Docket No. 07-0242, Order at 162. In that Order, the Commission etched out certain threshold requirements for any infrastructure rider

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<sup>1</sup> Mr. Schott testified on cross-examination: “But we’re not asking for approval of the acceleration. You keep saying, if the acceleration is approved, and we’re not asking for approval of the acceleration. We are asking for approval of Rider ICR.” Tr. at 65-66.

<sup>2</sup> The Company went from 1995 to 2007 without seeking rate relief.

*proposal* it would evaluate in the future. *Id.* The Proposed Order inappropriately presumes that, if a utility meets the “standards” articulated by the Commission in this Order, it must approve the Rider. However, there the Commission did not state that if these conditions were met it would approve an infrastructure rider – only that it “might have been easier to approve” if these provisions were included in the request. *Id.* As Staff of the Illinois Commerce Commission (“Staff”), CUB and the Attorney General for the People of the State of Illinois (“AG”) have concluded, the record in this proceeding does not support the need for extraordinary rate relief.

It is critical that the Commission understands that Peoples Gas has not committed to implement the accelerated program, even if it was awarded with Rider ICR. Mr. Schott on cross-examination agreed that it is the Company’s position that it will “retain authority over the pace of acceleration, if it occurs at all – regardless of approval – whether Rider ICR is approved.” Tr. at 61. If adopted, Rider ICR would recover the return on capital, depreciation expenses, and incremental operation and maintenance (“O&M”) expenses associated with investments in various types of distribution infrastructure. However, Rider ICR surcharges would *not* reflect merely incremental investments in those accounts over and above the typical annual investment amounts, nor would it reflect only those investments relating to the accelerated main replacement program. Instead, it assesses surcharges for *all* new investments in these accounts. Tr. 58; 161-162. Thus, the Company could refuse to implement the accelerated program – for any reason – yet still pass costs to ratepayers through Rider ICR to collect revenue for infrastructure investments unrelated to the accelerated program.

Even more troubling, if the Commission accepts the rationale that the accelerated replacement is necessary for public safety, the Company does not guarantee the very infrastructure replacement the Commission finds necessary will happen. The Company is in

essence holding the Commission hostage to its demand for extraordinary rate recovery, with no guarantee of meeting its end of the bargain. The unfortunate potential result of allowing Rider ICR would be awarding the Company with inflated rate base and excessive earnings in exchange for nothing.

The Proposed Order further rejects alternative cost recovery mechanisms for costs associated with the accelerated program as “burdensome,” relying on the Company’s claim of unnecessary administrative cost and regulatory lag. PO at 175. The Proposed Order presumes – without record evidence – that the alternative to Rider ICR is annual rate cases and that neither Staff nor intervenors would choose this scenario. The Proposed Order uses as justification for granting Rider ICR the desire to avoid frequent rate cases, and assumes that “it is reasonable to believe that Rider ICR may extend that period [between rate cases] and to that extent, it is reasonable.” *Id.* The Company, however, made clear Rider ICR was not determinative of the frequency of rate filings. The Company stated that it will file rate cases “as needed” and that the reasons for filing depend on many factors, including whether the Commission adopts Rider ICR. Tr. at 65-66. Thus, the record does not supply sufficient basis to conclude that Rider ICR will lessen the need for rate relief in the future, as the Proposed Order presupposes. PO at 175.

The Proposed Order misreads Staff’s position to indicate that, because Staff witness Stoller opines that Peoples should be required to accelerate its CI/DI replacement program, the Commission must award Peoples’ with Rider ICR, in order to achieve the desired benefits of the program. PO at 183-184. Quite to the contrary, Staff clearly recommends *rejection* of Rider ICR. Staff Init. Br. at 120-123. In fact, Staff points out that the Company failed to produce any analyses, research, projections or models to support its contention that Rider ICR was needed to raise sufficient capital and provide adequate, efficient, reliable and safe utility service at a

reasonable cost. *Id.* at 121. The modifications proposed by Staff and accepted by the Company were not enough to induce Staff to recommend its adoption. In its “Initial and Partial Evaluation” of the proposed rider, the Proposed Order astonishingly entirely avoids mention of Staff’s opposition to adoption of Rider ICR. PO at 174. In fact, Staff’s position is only mentioned for the purpose of supporting the conclusion that the replacement program is necessary. Likewise, in approving Rider ICR, the Proposed Order cites to Staff’s legal analysis as the “clearest and most straight-forward expose of the relevant case law on the exercise of our rider authority,” yet uses this analysis to come to the opposite conclusion. PO at 176. The Proposed Order ignores the fact that Staff determined that the record does *not* support the request for Rider ICR under that very same legal analysis. PO at 176; Staff Init. Br. at 121.

Similarly, the Proposed Order misinterprets CUB to oppose the Company’s proposed accelerated infrastructure replacement program, when in fact CUB explicitly stated it took no position on the implementation of the program itself. CUB Init. Br. at 3. This is a separate question from whether the Company has demonstrated that Rider ICR overcomes the legal and policy barriers to rider recovery of basic infrastructure costs. Like Staff and the AG, CUB argued that these costs do not meet the legal and policy criteria for rider recovery and are more appropriately recovered in base rates. *Id.*

As argued in CUB’s Initial Brief, Rider ICR violates the prohibition against retroactive and single-issue ratemaking, the test year rule, and the Public Utilities Act requirement that all rates and other charges be just and reasonable and used and useful. CUB Init. Br. at 4. The Proposed Order itself acknowledges that Illinois courts require adequate justification or need for rider recovery, such as alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses. PO at 177, *citing A. Finkl & Sons Co. v. Illinois Commerce*

*Comm'n*, 250 Ill. App. 3d 317 (1<sup>st</sup> Dist. 1993). The main point of contention is whether the circumstances present in the Company's desired accelerated main replacement program provide adequate justification for granting extraordinary rate treatment. Logic dictates the answer to this question is no. If the Company maintains that the accelerated main replacement program is discretionary and within its control, as it does, these costs cannot simultaneously be unexpected or volatile. Additionally, the fact that a utility's investment decisions and associated costs fluctuate based on the availability of capital and other external financial factors is not new or extraordinary. If this is used as a justification for rider treatment, ratepayers will soon be left holding the bag with a series of pass-through charges, presumed just and reasonable until proven otherwise.

The Proposed Order's legal analysis incorrectly concludes that "new, different and important features" distinguish this version of Rider ICR from its predecessor version rejected by the Commission, which allows it to overcome the prohibition against single-issue ratemaking. PO at 176-77. The Proposed Order notes that this new and improved Rider ICR includes a savings offset, which is to be re-calculated no less than every three years, and reconciliation hearings. *Id.* Peoples's proposal to include savings of \$6,000 per mile of main replaced, however, is simply a projection produced by Mr. Marano, (Tr. at 846), and does not represent a complete balanced analysis, synchronizing all aspects of the utility's cost of service, as required in a traditional test year rate proceeding. This concession should be regarded for what it is: a "bone," thrown in to sweeten the regulatory deal. The savings feature does not change the fundamental legal analysis demonstrating a violation of the rules against single-issue ratemaking and the test year rule, and does not overcome Rider ICR's fatal infirmities requiring rejection of it.

## **Exception 1:**

In accordance with the arguments presented above, CUB respectfully requests the Commission Conclusion on pages 165-197 be modified as set forth below:

### **Commission Analysis And Conclusion:**

The Company has proposed an Infrastructure Rider that supports an accelerated system modernization initiative. We begin our evaluation of Rider ICR by reviewing those portions of the testimony provided by PGL witness Marano that describe the current state of PGL's system.

#### **The Current Status of Peoples Gas' Infrastructure.**

~~Salvatore Marano, an independent engineering expert, considers PGL's system to be unique. He explains that PGL has been the sole distributor of natural gas to the people of Chicago for approximately 150 years. And, its pioneering history as a manufactured gas system, creating gas from coal and supplying it primarily for use as lighting, has resulted in the remaining legacy low pressure gas distribution system.~~

~~As a result of PGL's long and pioneering history of service to Chicago, Mr. Marano informs, the Company has the most miles of ductile iron pipe used for natural gas distribution in the United States; the system has the second largest combined mileage of cast iron and ductile iron main, as a percent of total miles of main, of any gas operator in the United States; and, the fourth greatest combined mileage of cast iron and ductile iron main. He explains that both the climate and geography of Chicago are factors that can adversely affect pipe integrity, e.g. poorly drained soils, large temperature variations, and conditions favorable for frost heave, which is when soil expands and contracts due to conditions of freezing and thawing.~~

~~Mr. Marano further informs that PGL operates an integrated gas distribution network comprised of medium pressure and low pressure systems. The 1,848 mile medium pressure system is approximately 47 percent of the Company's distribution network. There are 2,155 miles of low pressure system that amount to approximately 53% of the distribution network. The low pressure system is supplied by approximately 345 medium pressure to low pressure district regulator stations. Main lines transport gas from the regulator vaults to individual medium and low pressure customers via individual service lines. In all, Mr. Marano states, PGL operates and maintains approximately 4,000 miles of medium and low pressure gas distribution main, and 508,475 service lines.~~

~~According to Mr. Marano, PGL seeks to accelerate the replacement of its gas mains and services infrastructure and achieve modernization of its aging cast iron ("CI") and ductile iron ("DI") (together "CI/DI") as well as its antiquated low pressure system. While saddled with this~~

~~antiquated system, some of which is over one hundred years old, and operating with the risk posed by a cast and ductile iron main system, Mr. Marano maintains that PGL has prudently managed this system and the risks it poses. He opines that PGL's performance in this area is well in line with acceptable industry measures. Nonetheless, his testimony tells us, there is a need to pursue a more accelerated approach of upgrading this system to prevent or mitigate foreseeable future risk of system and asset failure.~~

~~With this background in mind, t~~The Commission proceeds to examine all of the ~~other~~ record evidence that bears on the Company's proposed Rider ICR.

Standards for System Modernization Proposals.

~~A Commission order is a powerful document. Among other things, it reveals the reasons for its actions in a particular case. As such, it informs the parties and other interested persons as to what outcomes might be reasonably expected in future cases.~~

The Commission rejected the Company's infrastructure rider proposal in its previous rate case on grounds of insufficient evidence. ~~But, in doing so, the Commission recognized the necessity of providing utilities guidance as to the specific type of information it required to evaluate system modernization proposals beyond Part 656 and Section 220.2 of the Public Utilities Act.~~

At page 161 of the Final Order for Docket No. 07-0242 the Commission wrote that:

It might have been easier to approve the rider had the Utilities included, or the Staff or the Intervenor's elicited, such information as: a detailed description and cost analysis of the proposed system modernization; an identification and evaluation of the range of technology options considered and analysis and justification of the proposed technology approach; a detailed identification and description of the functionalities of the new system, related both to system operation as well as on the customer side of the meter, as well as an identification and justification of functionalities foregone; analysis of the benefits of the system modernization, both to system operation as well as to customers; these benefits should include reductions in system costs as well as an analysis of the range and benefits of potential new products and services for customers made possible by the system modernization; an analysis of regulatory mechanisms to allow companies to both recover their costs of system modernization as well as to flow reduced system costs back to customers; and an identification and analysis of legal or regulatory barriers to the implementation of system modernization proposals. Final Order at 162.

Altogether, we set out six standards that were required at a minimum before any infrastructure rider could be approved. Note that, however, the Commission in no way presupposes that, if these conditions are generally met, a utility may expect its request for an infrastructure rider

to be granted. The Commission is obligated by law to review the request based on the evidence of record, as it applies to the relevant legal standards. And, these are the very standards by which the Commission will evaluate the Company's proposed Rider ICR.

The Commission set the standard and Peoples Gas rightfully relied on these standards in this proceeding. We now look to see if the Company's evidence is sufficient and we take studied account of what it shows.

*Standard No. 1—A detailed description and cost analysis of the proposed system modernization.*

The record informs how the aging CI/DI mains require a higher level of risk management and generate a larger number of main leaks and how these would be replaced with polyethylene pipe materials and, when necessary, coated cathodically protected steel, that are "state of the art" in gas main and service materials.

The system modernization will upgrade PGL's distribution network from the low pressure legacy system (prone to outages from water infiltration) to a medium pressure system that will provide customers with new functionalities and benefits.

By accelerating and replacing larger amounts of main each year, Peoples Gas can add a zonal approach to the program to allow for greater economies of scale and coordination with the City and other utilities with respect to their infrastructure projects.

A detailed cost analysis was prepared by Mr. Marano to show, as best as could be projected, what the construction costs would be for replacing the CI/DI mains at the current rate (which would have the replacement completed in the year 2059), and under a nineteen year accelerated replacement scenario which would have Peoples Gas complete its replacement program by the year 2029.

The Marano analysis concludes that the accelerated main replacement program will cost \$432 million (in 2010 dollars) less in construction costs than Peoples Gas' current main replacement program over what would be its 49 year life span. After subtracting the incremental costs (termed "Incremental O&M" in the analysis) of program management and labor (such as meter installation work) associated with the accelerated program and that are projected to be \$159.7 million, Mr. Marano projects that the net construction cost savings from accelerating the main replacement program construction would be \$272.3 million.

There is testimony from Mr. Marano stating that the new distribution system would provide savings in Peoples Gas' ongoing operations and maintenance ("O&M") costs by substantially reducing the amount of leak repairs, leak surveys, leak rechecks, emergency responses, regulator station inspection and maintenance, vault survey and maintenance, lost gas and inside safety inspections. Compared to the scenario where Peoples Gas would continue its current main replacement plan, the

accelerated scenario would generate a total of \$244 million in O&M cost savings over that same time period.

*Standard No. 2—An identification and evaluation of the range of technology options considered, and an analysis and justification of the proposed technology approach*

The evidence shows that the materials to be used in replacing PGL's aging CI/DI mains are the state-of-the-art in gas main and service materials. And, the upgrade to a medium pressure from a low pressure distribution system will bring Peoples Gas current with the standard for natural gas distribution systems. The record shows that a medium-pressure system also is less costly to construct because it allows for smaller diameter pipe to be used, and can take advantage of PE pipe, which is less expensive than coated steel pipe.

Among other things, Mr. Marano explains that the company's use of directional drilling technology reduces construction restoration costs and eliminates the need to dispose of spoil caused by open trenching. His testimony describes the options available for approaches to pipe replacement and explains why the recommended use of a zonal approach to create economies of scale that may create further cost savings as well as provide benefits to the City and other utilities via the coordination of their respective infrastructure projects.

There is also testimony explaining how its "double decking" of mains, i.e., placing main in the parkways on each side of a street rather than a single main in the middle of the street, will create a number of specific and identifiable benefits.

*Standard No. 3—A detailed identification and description of the functionalities of the new system (related both to system operation as well as on the customer side of the meter), and, an identification and justification of the functionalities foregone.*

With respect to the old low pressure system, Peoples Gas' expert Mr. Marano states that no functionalities will be foregone when that system is replaced.

The new system, Mr. Marano states, will be simpler, more reliable and optimal in design. Over 300 medium to low pressure regulator stations, along with their maintenance costs, can be eliminated and replaced with 54 new high to medium pressure regulator stations with a common design that will reduce construction costs and future maintenance costs. The problem of water infiltration (common with low pressure systems), and that can cause outages, will be eliminated. The moving of meter sets to outside the house will provide greater access and improved safety, and the new meters combined with the constant pressure provided by the modernized system will measure gas usage more accurately.

In terms of system operation and maintenance, it is shown that new regulator stations will be in the parkway, providing safe access and reduced impact on traffic. This benefits the City because it will

encounter fewer regulator vaults that impede street construction. Eliminating the medium to low pressure regulator stations will reduce the amount of training, inspection and maintenance necessary for upkeep, and correspondingly reduce the potential for human error. The increased use of PE pipe will reduce the risk of leaks caused by corrosion and reduce the amount of pipe required to be leak surveyed annually.

Customers will benefit from the functionalities of a modernized system and no longer need to install costly gas boosters and safety back check valves to provide elevated pressures for modern energy efficient appliances and back up generators. Service lines will have excess flow valves — unavailable with a low pressure system — which will reduce the potential property damage caused by a damaged service line. Emergency response personnel, e.g., the City's Fire Department, will be able to shut off gas to a building from the outside meter sets, which potentially could reduce property damage in fire and other emergency situations.

Additional beneficial functionalities were identified by Mr. Marano and include, fewer joint leaks because PE pipe is fused and steel pipe welded; use of PE pipes will enable crews to isolate gas leaks quickly by closing an existing valve or squeezing off the pipe upstream and downstream from the leak and the moving of gas mains out of the streets and into parkways will reduce third party excavation damage, accidental gas line cuts and increase worker safety.

*Standard No. 4 — Analysis of the benefits of the system modernization, both to system operation as well as to customers (including reductions in system costs, and an analysis of the range and benefits of potential new products and services for customers made possible by the system modernization).*

Mr. Marano explained that Peoples Gas' aging CI/DI mains are comprised of materials that pose a risk of catastrophic failures, and that this risk to customers and to Peoples Gas' personnel is what the Company must manage. While it does a good job managing these risks, Mr. Marano makes clear that these materials ultimately will fail and need to be replaced, and that the money costs of managing this system will continue to rise as it ages. The proposed system modernization will eliminate both the risks, and the high maintenance costs required for handling older higher risk materials.

The record evidence shows that modernizing Peoples Gas' distribution network will generate savings in Peoples Gas' O&M costs that will benefit customers. Mr. Marano's analysis projected that if Peoples Gas accelerated its main replacement program, its O&M savings would amount to \$244 million between the years 2011 and 2059 because of a substantial reduction in the amount of leak repairs, leak surveys, leak rechecks, emergency responses, regulation station inspection and maintenance, vault surveys and maintenance, lost gas and inside safety inspections.

Customers would further benefit from the synergies and efficiencies in system maintenance by no longer being inconvenienced by the need to

~~schedule inside safety inspections, suffer from water infiltration outages or the freeze up of low pressure risers. A medium pressure system upgrade will enable customers to more easily use technologies and appliances, particularly high efficiency appliances, not compatible with the low pressure system now in place. To operate these types of appliances and natural gas fired back up generators on the low pressure system, customers are required to install and maintain electric powered gas pressure booster systems which can cost between \$20,000 and \$50,000.~~

~~This upgrade would be important for facilities such as schools, hospitals and emergency services providers, which are required by Chicago code to have back up generators installed. These facilities, if now located on the low pressure system, need a pressure booster system installed to use a natural gas powered generator, or else use gasoline or diesel powered versions which are less environmentally friendly and potentially dangerous.~~

~~A medium pressure system would allow all customers to install high efficiency appliances such as tankless water heaters, fan assisted heaters, home generators and commercial grade cooking appliances. Not only is the availability of such high efficiency appliances important for the environment and energy conservation, but helps customers save money as well. An example is a tankless water heater that is estimated to cost \$265 to operate a year, as opposed to \$326 for a 40 gallon gas heater or \$453 for a 40 gallon electric tank.~~

~~Still another financial benefit to customers of the new medium pressure system is that it will allow customer use of corrugated steel piping, which is more economical and will allow customers to reduce their building construction costs.~~

~~Other significant "environmental" benefits of system modernization, detailed by Mr. Marano appear of record. The elimination of Peoples Gas' CI/DI mains and their replacement with PE and protected steel pipe dramatically reduces the amount of greenhouse gas emissions from the company's mains. Based on a study by the U.S. Environmental Protection Agency, Mr. Marano estimated that by accelerating the main replacement program, Peoples Gas could further reduce the emission of greenhouse gases by approximately 10,500 Mef per year. Upgrading the system to medium pressure also eliminates the need for the collection, testing and disposal of water that enters the gas distribution system.~~

~~Another important benefit of accelerating the main replacement program to the City is the creation of a substantial number of jobs, given that additional people will be needed to perform the construction work (both internal and external to the company), the meter installations and reights of service and the management of the work. When questioned at the hearing as to whether Peoples Gas could accelerate the main replacement program without hiring additional personnel, Mr. Marano testified: "Absolutely not." Tr. at 887-888.~~

Peoples Gas argues that the evidence demonstrates that Rider ICR would generate not only financial benefits for customers in the form of construction and O&M cost savings, but additional benefits to customers such as enhanced safety, energy conservation, increased functionalities and appliance choices and reduced environmental impacts. Peoples Gas thus concludes that the evidence in the record strongly weighs in favor of authorizing Rider ICR to help bring these benefits to customers sooner than otherwise possible.

#### The Commission's Initial and Partial Evaluation (Standards I—4)

While there are additional standards and evidence for the Commission to consider, we pause at this juncture to assess those items that PGL witness Marano addressed. And, in reviewing all of the evidence and arguments we are aware that parties such as the AG, CUB, Staff, the City and the Union take various positions on Mr. Marano's testimony. These we must consider.

In a number of different ways, the AG and CUB claim that Rider ICR is not needed. They make light of PGL adhering to the Commission's standards claiming that these are minimal and that PGL should have also shown that the existence or absence of Rider ICR would affect its cost of capital, impact its capability to finance necessary improvements or jeopardize its ability to provide safe and reliable service to its customers. They further attempt to undermine Mr. Marano's analysis on the costs of acceleration by presenting what they term "a revenue requirements analysis." The respective testimonies of Company witness Grace, Schott and Marano, however, dispute several particulars of this presentation on individual grounds as well as on the general proposition that it fails to account for the way that Rider ICR would actually work. We view the analysis as incomplete, sparse on narrative support, and unable to stand on its moorings. Further, it does not incorporate the costs associated with the ongoing management of the risk posed by an aging system that will likely increase as the system continues to age. SDM 1.0 Rev. at 29. Another factor left unconsidered or accounted for in the AG and CUB analysis is Mr. Marano's testimony that if in the future, failures posing a risk to the general public were to manifest themselves, a "reactive" acceleration replacement program at that time could present costly and difficult management issues. SDM 1.0 Rev at 29. For the Commission this is far more than just a cost issue; it is a safety issue. And while such costs are not estimated by the AG, and may be impossible to estimate, it falls on the Commission to make both these types of costs and circumstances avoidable. To this end, even AG-CUB witness Rubin recognizes that the decision on whether to implement an accelerated infrastructure program such as Rider ICR should not be based solely on costs but on factors such as safety and reliability as well. Tr. at 984.

Even as to costs and savings, the Commission observes the AG to dispute nothing about Mr. Marano's testimonial assertion that adding a zonal approach to the acceleration program would allow for economies of scale that decrease costs (and provide for better coordination with City

activities and other infrastructure projects). Yet, it is evidence such as this that the Commission considers material to our decision-making.

The AG asks that we deny Rider ICR for the same reasons that we rejected another utility's proposal. But, the AG is wrong in its reading and citing of our order in the Nicor Gas rate case. We rejected that infrastructure proposal for failure to follow with our standards. That we took seriously and indeed, settled on these standards was made clear in what the Commission wrote in its Order for Docket 08-0363. After setting out the requirements established in our 2008 PGL/NS rate Order (and reconfirmed in this proceeding), the Commission stated that:

In the future, we encourage parties to adhere to the evidentiary requisites set forth in one of our orders when, as here, that order is directly on point as to what proof is needed to establish a particular argument.

That is not the situation reflected here. To the contrary, Peoples Gas is providing the Commission the very type of information we require.

The AG correctly points out that Mr. Marano conducted three different timing scenarios, i.e., 2025, 2030 and 2035. And, we observe both the AG and CUB to argue strenuously against Mr. Marano's recommended 2030 completion date. But, we do not see either the AG or CUB to support any of the other acceleration dates on record.

The AG contends that nothing on record explains how the accelerated rate of main replacement for a 2030 completion date can be accomplished given the Company's current replacement operations. This we regard as an internal working matter and we observe the record to answer the AG's concerns both in terms of what the Plan submitted with Marano's surrebuttal testimony shows and his clear and direct explanation that more workers will be need to be hired. Indeed, this is one of the economic benefits of acceleration and the reality is that it could not be coming at more opportune time.

Altogether, the criticisms of CUB and the AG do not address or challenge Mr. Marano's study of the Company's current system risks. Nor do they dispute any of the vast and different benefits to PGL's customers, to its workers, or to the City planning personnel and crews that are shown to be provided for under the Company's proposal. At bottom, the only thing that the AG and CUB press for, is maintaining the *status quo*.

The City takes an altogether different position and view of the evidence. It focuses our attention on Mr. Marano's testimony stating that CI/DI mains are "higher risk materials because of their unpredictable and catastrophic failure mode." PGL Ex. 1.0 (Rev.) at 5. And, it would have the Commission note this witness's further testimony that accelerating the replacements of these "high risk materials will increase system safety and reliability and reduce the likelihood of subjecting the public and customers to the adverse effects of pipe failures." *Id.* at 6. Notably, neither the AG nor CUB dispute what the City points to and argues.

For its part, the City makes clear to us that it views the state of infrastructure in Chicago and enhancing its safe maintenance and operation as being very important. As such, the City supports PGL's proposed acceleration main replacement and Rider ICR as representing a significant effort to bolster this critical aspect of Chicago's infrastructure.

The Union represents the employees of Peoples Gas who work on its cast iron and ductile iron ("CIDI") mains on a daily basis. As such, we agree that it is uniquely positioned to comment on Peoples Gas' main replacement program and the benefits accelerating that program will bring and it recommends that the Commission authorize Rider ICR. For its part, the Union points out that the testimony of Salvatore Marano, an engineering expert with significant experience working with and examining natural gas distribution systems, well establishes that accelerating the main replacement program will help enable the Company to enhance the safety of its distribution system, simplify its operation, reduce the potential for operator error, increase the system's reliability, reduce the costs of operating and maintaining the system, and remove the potential of crews working on mains being injured by cast iron or ductile iron failures. By this account, the Union turns our head not only to the issues of safety and reliability for the general public, but also to the important worker safety benefit that Rider ICR provides.

Further, the Union would have the Commission not overlook another critical benefit brought on by the acceleration of the main replacement program, i.e., a significant increase in the number of jobs as workers both in positions staffed by Union members, as well as in management and outside contractors. The Union observes Mr. Marano's testimony to establish that the accelerated main replacement program could not be carried out without additional personnel being hired. Given the realities of the economy and the unemployment rate in Illinois, the Commission realizes that the Union's position on the importance of generating jobs in these times must be factored in on some level in our decision on Rider ICR. As we see the Union to assert, Rider ICR is the key component of bringing all the resources to bear on an important beneficial effort.

Staff does not challenge the cost-benefit analysis. Nor does Staff dispute any of Mr. Marano's testimony as it relates to the acceleration of the Company's modernization. To the contrary, Staff witness Stollar testified that he is absolutely convinced of the need for Peoples Gas to replace, and on an accelerated basis, its current cast and ductile iron low-pressure mains. On the basis of his convictions, Staff has even developed its own proposal to address the situation of the Company's aging and outdated system.

Along with all the many other positive attributes of an accelerated main replacement presented in Mr. Marano's testimony, we observe the provision of important environmental benefits. Both this state and the City have long been at the forefront in considering the health of their citizens and in undoing or preventing damage to the environment. The

testimony of Mr. Marano demonstrates for us that the Company's proposal serves these interests as well.

As such, when considered in terms of the critical values of public safety and reliability and environmental good, there is simply nothing on record to counter the Company's initiative to accelerate infrastructure improvements. Indeed, we see overwhelming support for a modernization program on these very grounds.

In the final analysis, we consider Mr. Marano's statement that:

~~My testimony will provide my opinion and support for the accelerated replacement of PGL's gas mains and services infrastructure based on the need for reduction of risk to the public, the public good caused by a modern asset based gas distribution system and the economic advantages of an accelerated program. PGL Ex. SDM 1.0 Rev. at 3~~

The Commission concludes that Mr. Marano has provided testimony that supports this proposition and that the evidence presented fully meets and satisfies for each of the initial four criteria that we established. All total, the critically material and relevant aspects of evidence presented by Mr. Marano are un rebutted, and the positions of the City, the Union, Staff and even the testimonial admission of AG CUB witness Rubin, compel this Commission to seriously consider the Company's proposed Rider ICR. And, our evaluation continues.

#### Remaining Standards

The Commission now begins its review of the evidence and arguments on the remaining two standards that we established.

~~Standard No. 5—An analysis of regulatory mechanisms to allow companies to both recover their costs of system modernization as well as to flow reduced system costs back to customers.~~

The Company provided extensive evidence regarding the desirability of accelerating the modernization of its CI/DI main replacement program, but also made clear the its current system is begin safely and prudently managed under the current replacement scenario.

We observe Staff witness Lazare to have said that even if an accelerated program can be supported, that does not necessarily make a case for the rider mechanism. Both the AG and CUB ~~seize on this statement to argue against Rider ICR agree.~~ These parties claim that the traditional ratemaking mechanism for recovering infrastructure investments of any kind is base rates. And, they argue that the only testimony to address the alleged need for a special rider, is PGL witness James Schott's statement that, as the financial crisis has made capital more expensive to obtain, proposed Rider ICR provides the Company a greater level of certainty of recovery on and of the investment in cast iron main, that is essential to keep capital costs associated with infrastructure improvements reasonable.

For its part, the City recognizes that riders are to be used in extraordinary circumstances and that requests for the recovery costs through riders require special scrutiny. And, the City recognizes that rider recovery is inconsistent with the traditional manner of utility regulation. Nevertheless, the City points out that replacing legacy mains as expeditiously as reasonable is an “extraordinary” situation and it supports Rider ICR.

~~The record shows that before proposing Rider ICR, the Company considered and rejected two other methods for recovery of costs associated with the acceleration of infrastructure expenditures, i.e., annual rate case filings and a deferral mechanism. As we understand the record, annual rate case filings were rejected by the Company due to the administrative cost and effort involved in being in a perpetual stream of rate cases. And, regulatory lag further exacerbates the problems associated with annual rate case filings. Future test years rely on forecasts and given the 11-month rate case period itself, the forecast of future capital expenditures must be developed more than a year before the test period begins.~~

~~From our perspective, rate cases consume vast amounts of time, money and resources, and are not only burdensome for utilities and other parties. They also strain the limited resources of the Commission and its staff and divert attention from other pressing matters. Ultimately too, rate case costs are consumer costs. We cannot and will not speculate on when the Company will need to come in for a rate case in the future. But, it is reasonable to believe that Rider ICR may extend that period and to that extent, it is reasonable. Notably too, we do not see Staff or any other party to say that they prefer annual rate cases.~~

~~Likewise, no party has advocated for a deferral mechanism. A deferral mechanism is based on actual expenses. Under this mechanism, costs that would be recovered currently under Rider ICR would be deferred until the next rate case and carrying cost would accrue at the Company’s pre-tax cost of capital. As costs would be incurred each year, the deferral would grow each year. Depending on the length of time between rate cases, there could be significant “rate shock” in the year that the deferral is actually recovered in rates. And, the deferral could place a strain on the balance sheet since the deferred costs would need to be financed.~~

~~The flaws with deferral accounting are obvious. To the extent that some costs are recovered through ICR, we see less of a harmful impact on customers in terms of “rate shock,” a warning put to us by the AG in arguments on other sections of this order. Thus, the deferral mechanism is not a viable or welcome alternative to Rider ICR.~~

~~Furthermore, the record shows that Although Rider ICR, was proposed, is modeled on our rules at Part 656, which is a reasonable starting point for an infrastructure recovery rider such as Rider ICR. Thus, it is not a new or unusual mechanism with which the Commission is unfamiliar. And, the subject matter at hand lends itself ideally to the rider~~

mechanism. There are several changes that the Staff proposed (and that Peoples Gas accepted) to enhance the clarity of the rider and to improve the Commission's ability to oversee cost recovery under the rider. We will carefully review all of the Staff modifications accepted, and contested, by the Company as we continue with our evaluation of Rider ICR to ensure that the mechanism itself is well implemented.

*Standard No. 6—An identification and analysis of legal or regulatory barriers to the implementation of system modernization.*

It is well-established that the Commission sets rates in two ways, i.e., by base rates and by an automatic adjustment clause, i.e. the rider mechanism. This is no different from the way rates are set in other jurisdictions. The Commission has authorized many riders over the years, and not all of these have been challenged in the courts but only in exceptional circumstances. That said, the clearest and most straightforward expose of the relevant case law on the exercise of our rider authority presents in Staff's Initial Brief.

Staff takes us back many decades to the opinion in *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607 (1958) where the Illinois Supreme Court determined, in a case of first impression, that the Illinois PUA vested "the Commission with power to authorize an automatic adjustment clause to be filed in a rate schedule **in the proper case.**" *Id.* at 614. (Emphasis added). This opinion, as Staff rightly points out, suggests that a decision to allow rider recovery must be adequately supported by the facts and circumstances of the rider under consideration.

In the more recent opinion in *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill. App. 3d 617 (1<sup>st</sup> Dist. 1996) the court again made clear that the Commission "has the power to authorize riders in a proper case and such authorization will not be reversed absent an abuse of discretion." Such an abuse would present itself if we were to act arbitrarily, or capriciously, or irrationally.

While the Commission confirms that it clearly has the discretionary authority under the PUA to provide for rider recovery of costs in appropriate circumstances, we need to examine the record in this proceeding and, as our standards direct, if there are any legal or regulatory barriers to bar our adoption of Rider ICR.

#### *Single-issue ratemaking*

Generally, riders are challenged on the grounds of single-issue ratemaking. And we see the AG and CUB to bring this challenge here. ~~To be sure, this claim had some validity in Peoples Gas' previous rate case, and~~ The facts in the present case do not differ substantively from those in the Company's previous rate case. There, as here, the Commission agreed that the version of Rider ICR then at issue violated the single-issue ratemaking rule because it failed to account for savings generated by the accelerated main replacement program. But, as it is being proposed in the instant case, Although Rider ICR as proposed in

~~this proceeding has incorporated some minor new, different and important features. Most notably, it includes a factor for offsetting savings, generated by the accelerated program, to customers, thus preventing any over or understatement of Peoples Gas' overall revenue requirements by Rider ICR. Further, and at the suggestion of our Staff, this provision of Rider ICR has been further modified to and a requirement for the re-calculation of this savings factor no less than every three years, this is not sufficient to overcome its legal and policy infirmities, with the Commission and other parties free to initiate proceedings to do so more frequently if necessary. In addition, there are reconciliation hearings provided for Rider ICR.~~

Staff notes that all riders would seem to raise single-issue ratemaking concerns since they are typically used to recover specific or isolated costs. Yet, Staff further observes that the opinion in *A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317 (1<sup>st</sup> Dist. 1993) established that rider recovery is exempt from the prohibition against single-issue ratemaking when there is adequate justification or need for rider recovery – such as alleviating the burden imposed upon a utility in meeting unexpected, volatile or fluctuating expenses. ~~In this regard, we note the AG very own arguments to accept that variations may occur with respect to construction costs. Staff concluded, however that such adequate justification simply does not exist in this record.~~

~~Staff further leads us to the Illinois Supreme Court's specific pronouncements that the rule against single issue ratemaking does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment. *Citizens Util. Bd. v. Illinois Commerce Commission*, 166 Ill. 2d 111(1995). Indeed, we find that the specific provisions of Rider ICR reconcile with the Illinois Supreme Court's recognition that "riders can generally be expected to provide a more accurate and efficient means of tracking costs and matching such costs with recoveries than would base rate recovery methods." *Id.* at 138-139 (emphasis added). We recall Mr. Scott's testimonial assertion that rider treatment provides assurance to ratepayers that they will only pay for the actual costs of infrastructure in the ground. On all these legal and factual grounds, the Commission concludes that the rule against single-issue ratemaking is not a bar to our adoption of Rider ICR.~~

~~But, we observe still other challenges set out by the AG and CUB that must be addressed.~~

#### *The Prohibition Against Retroactive Ratemaking.*

According to the AG, Rider ICR also raises retroactive ratemaking concerns. It notes that Section 9-201 of the Public Utilities Act ensures that rates for utility service are set prospectively. And, it points out that the Illinois Supreme Court has held repeatedly that the Public Utilities Act does not permit retroactive ratemaking, i.e., once the Commission establishes rates, the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. The rule prohibiting

retroactive ratemaking, the AG asserts, is consistent with the prospective nature of the Commission's legislative function in ratemaking and promotes stability in the ratemaking process. *Citizens Utilities Co. v. Illinois Commerce Commission*, 124 Ill.2d 195, 207, 529 N.E.2d 510 (1988).

The AG asserts that proposed rider ICR violates the prohibition against retroactive ratemaking by generating monthly surcharges based on a forecasted level of investment in six plant accounts for a particular 12-month period. And, it retroactively adjusts rates in an annual reconciliation proceeding. This retroactive adjustment of rates, the AG argues, is not unlike the review ruled illegal in the *Finkl* decision, where the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudency review, by calling it a violation of the rule against retroactive ratemaking.

We agree with the AG that the court in *Finkl* accepted the argument that Rider 22 violated the prohibition against retroactive ratemaking. ~~But, as we observed in our previous study of the matter, there is nothing in the *Finkl* opinion that provides an explanation of the court's reasoning. There is only mention that Rider 22 provided for a prudency review of the expenses passed on to customers with the possibility of refunds if the rates were too high. And, the court summarily cited to *BPI v. ICC*, 136 Ill. 2d 192 (1989), for the proposition that "[o]rdering of refunds when rates are too high, and surcharges when rates are too low, violates the rule against retroactive ratemaking." *Id.* But, that is not the final pronouncement on the matter by the Illinois courts.~~

We observe again that parties in the *CILCO* case relied on *Finkl* in arguing that the riders in general violate, among other things, "the prohibition against retroactive ratemaking," and the Commission's "test year rules." But, the court rejected such a broad reading of *Finkl* and explained its limitations by stating, in part, that:

...we read *Finkl* as holding that the Commission abused its discretion in allowing a rider recovery mechanism under the circumstances because demand-side management costs are not of an unexpected, volatile or fluctuating nature so as to necessitate recovery through a rider. Again, we do not read *Finkl* as holding that the Commission does not have the authority to allow recovery of costs through riders. Given our view of the *Finkl* court's holding, we view the opinion's discussion of retroactive ratemaking and test year rules as dicta. 255 Ill. App. 3d at 885 (emphasis added).

While not explicitly rendering an opinion on the retroactive ratemaking arguments, the court clearly challenged the Commission's authority to institute riders outside of the proscribed context of unexpected, volatile or fluctuating expenses. Peoples has not demonstrated costs to be recovered under Rider ICR meet this test.

We are concerned that Peoples Gas has not committed to implement the accelerated program, even if it was awarded with Rider ICR. Mr. Schott on cross-examination agreed that it is the Company's position that it will "retain authority over the pace of acceleration, if it occurs at all – regardless of approval – whether Rider ICR is approved." Tr. at 61. If adopted, Rider ICR would recover the return on capital, depreciation expenses, and incremental operation and maintenance ("O&M") expenses associated with investments in various types of distribution infrastructure. However, Rider ICR surcharges would *not* reflect merely incremental investments in those accounts over and above the typical annual investment amounts, nor would it reflect only those investments relating to the accelerated main replacement program. Instead, it assesses surcharges for *all* new investments in these accounts. Tr. 58; 161-162. Thus, the Company could refuse to implement the accelerated program – for any reason – yet still pass costs to ratepayers through Rider ICR to collect revenue for infrastructure investments unrelated to the accelerated program.

~~The rider challenges in that case continued for review by the Illinois Supreme Court in CUB v. ICC. At the very outset of its discussion, the Court recognized that riders "often include a reconciliation formula, designed to match recovery with actual costs." CUB v. ICC, at 133 (citing to City of Chicago, 13 Ill. 2d 607, 609 (1958)). While not addressing the retroactive ratemaking argument directly, because it was found to be waived, the Court found nothing unusual with the reconciliation procedure terms for the rider at hand. The Court observed that the reconciliation formula used to determine the amount of the rider charge includes a matching of costs incurred with the revenue realized. In the end, the Court found the Commission's approval of a rider for the recovery of coal tar clean up costs to be within its authority and not against the manifest weight of the evidence.~~

In our Order for Docket 07-0242, the Commission presented a detailed examination of what the prohibition against retroactive ratemaking really means and how it concerns rider mechanisms. We observed, after careful study, that CILCO is the only case that directly considers the rule against retroactive rulemaking in the "true" rider situation. And, we further noted that CILCO strictly limits the application of that doctrine by Finkl to the fact particulars in that decision and does not embrace it. This was well recognized and looked upon favorably by the Illinois Supreme Court in CUB v. ICC, both in its discussion of reconciliations generally, and in its review of the specific reconciliation mechanism that was at hand. ~~The AG's argument does not consider any of the important case law in the field.~~ In the end, as in Docket 07-0242, based on the evidence of record we are not shown nor do we independently find any serious legal obstacle to the adoption of Rider ICR on the basis of the retroactive ratemaking doctrine.

#### *Test Year Rules*

The AG maintains that Rider ICR also violates the Commission's "test year rules," the purpose of which is to prevent a utility from overstating

its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. And, the AG maintains that the establishment of a test year rate base, reflecting gross additions, retirements and transfers to plant-in-service, concluding with plant balances and total plant-in-service is a critical component of the calculation of each company's revenue requirement. The calculation of Peoples' plant additions or capital expenditures for purposes of setting rates, the AG contends, is subject to test-year principles. ~~According to the AG,~~

We agree that Rider ICR would provide expedited, piecemeal rate increases for incremental capital investment between rate case test years, in violation of the Commission's test year rules. As such, ~~the AG argues,~~ Rider ICR violates the Commission's and Illinois law's test-year principles by selecting only one component of the revenue requirement, in this case main and ancillary infrastructure investment, tracking changes in that revenue requirement component and then assessing rate adjustments to recognize this change.

~~In our Order for Docket 07-0242, the Commission reviewed all of the relevant case authority when considering a similar challenge to the rider mechanism. We noted at that time that no less authority than the Illinois Supreme Court directly addressed the argument that a rider violates the Commission's own test year rules and ultimately settled the question in its opinion for CUB v. ICC. At the outset, the court discussed that the test year rule set out at 83 Ill. Adm. Code 285.150, is designed to avert a mismatching of revenues and expenses that might permit a utility to inaccurately portray a higher need for rate increases. The Court looked favorably on the Commission's explanation that it was not attempting to evaluate or adjust all aspects of the utilities' base rates such that the test year filing was not a prerequisite. Id. In the end, the Court resolved that the test year rule seeks to avoid a problem that is simply "not present" when expenses are recovered through a rider. And, it upheld the rider.~~

~~The Court's ultimate assessment of the test year rules is applicable to the situation at hand. The Commission finds the claim of a test year violation for Rider ICR to ~~lack~~ have merit and thus poses ~~no~~ legal ~~or~~ and regulatory obstacles to its implementation approval of the rider.~~

#### *Final Legal Analysis*

~~In City of Chicago v. Illinois Commerce Commission, 13 Ill. 2d 607 (1958), the Illinois Supreme Court declared that the Commission is vested with the authority to make "pragmatic adjustments" as part of its ratemaking function. The Commission does not take its rate setting obligations or its discretionary authority lightly. As we stated on a previous occasion, the Commission's discretion is not exercised according to its inclination, but rather on a sound judgment and reasonable assessment of the record.~~

We find on the entirety of this record in this case, that Rider ICR violates the legal proscriptions against rider recovery of basic infrastructure costs

and is therefore not approved. The Commission need not, then, continue its analysis to evaluate the merits of Staff's proposed tariff revisions. reflects a "unique" system needing improvement (Marano testimony); a pressing public concern of "extraordinary" circumstance (City); a necessary safety initiative (Staff); a worker safety benefit (Union); and, a fluctuating cost matter (AG and Marano). The City of Chicago has it right. The Commission is in the position of removing disincentives to the acceleration of system modernization and it is the record that compels us to this end. All of what we have reviewed presents such an extraordinary and unique circumstance as upon which we might properly and should pragmatically exercise our legal authority to approve Rider ICR.

Our evaluation of Rider ICR, however, is still not complete.

#### The Rider ICR Tariff

A rider will rise or fall on the features and mechanics included in the tariff language. Staff knows this and it has provided a number of concrete recommendations that are intended to ensure that there is proper regulatory oversight and that Rider ICR is implemented in the correct way. No party other than Staff has given us any specific proposals to consider.

We do see, however, CUB and the AG to claim that the monthly surcharges under the Rider ICR mechanism are not adjusted for such events as work slowdowns that might be triggered by the economy or by weather. We see no merit to such an argument nor have we been shown how this would be or why it needs to be translatable into the tariff.

Similarly, the AG and CUB contend that there is no guarantee that all savings resulting from CI/DI main replacement will be passed through to ratepayers through the Rider ICR tariff. According to the AG, the total possible savings offset under the tariff is \$11.6 million (6,000 per mile x 1,929 miles = 11,574,000) that Rider ICR would credit customers. On record, however, we find Mr. Marano's testimony to be clear in explaining that customers will receive savings in part through Rider ICR and, in part, through traditional ratemaking such that the \$6,000 per mile savings offset in the rider is only one piece of the savings.

Finally, the AG complains of the 5% cap in Rider ICR that establishes a ceiling on the amounts to be collected under the rider. According to its witness Rubin, the AG argues, the cap would be reached every one to two years and for the Company to continue with spending and earning a return on its investment rate cases would need to be filed accordingly. It seems clear from this argument that AG does not actually opposes the 5% cap but that this is another way to press its opposition to accelerated main replacement.

On record, we observe that Staff witness Hathhorn proposed eleven recommendations concerning Rider ICR should the Commission approve the tariff. Staff points out for us that the Company accepted Staff's first,

~~second, fourth, fifth, sixth, seventh, and eighth recommendations and reflects for us Rider ICR with the agreed to changes.~~

- ~~• Section C (a) of the tariff was clarified to state: “The annual amount to be billed under Rider ICR shall not exceed the product of Annual ICR Base Rate Revenues multiplied by 5%.”~~

- ~~• Section H of the tariff was clarified to require the Company’s annual petition, testimony, and reconciliation statement be filed each year no later than March 31.~~

- ~~• The scope of the annual reconciliation referred to in Section H of the proposed Rider was modified to include a determination whether all costs recovered through Rider ICR were prudently incurred, just and reasonable.~~

- ~~• Section I Annual Internal Audit of Rider ICR, was revised to add language to the proposed Rider ICR requiring the annual internal audit to include at least the following tests:~~

- ~~(1) test that costs recovered through Rider ICR are not recovered through other approved tariffs;~~

- ~~(2) test customer bills that all Rider ICR Adjustments are being properly billed to customers in the correct time periods;~~

- ~~(3) test that Rider ICR revenues are properly stated; and~~

- ~~(4) test that actual costs are being identified and recorded properly to be reflected in the calculation of the rates and reconciliation.~~

- ~~• Section B of the tariff was modified to reflect the Company’s updated initial qualified infrastructure plant (“QIP”) percentage for House Regulators, Account 383, of 90%.~~

- ~~• Factor IOM of the tariff that provides for the recovery of incremental operating and maintenance costs through Rider ICR was removed from the rider.~~

- ~~• Incentive compensation costs were specifically excluded for cost recovery under Rider ICR.~~

~~According to Staff, its third and tenth recommendations from direct testimony were withdrawn. It tells us, however, that two other recommendations of Staff witness Hathhorn remain contested. The Commission is pleased to see that the Company has accepted most, if not all, of Staff’s proposed modifications and we find these to be reasonable in the premises. We consider Staff’s remaining recommendations out of numerical order, for reasons that will become obvious in time.~~

~~The first of the disputes, concerns Staff’s “eleventh” recommendation that the actual savings factor (“ActSav”) be updated at least every three years. To make its point clearer, Staff explains that the Company agrees to a triennial update of the factor, but what the Company disagrees to is the proposed tariff language allowing updates “sooner if demonstrated to be necessary by the Company or any other party.” In this respect, the Company argues that if the Commission wishes to review the factor more frequently, it can initiate a proceeding to do so. As Staff further explains it, the Company does not dispute the Commission’s authority to review the factor more frequently, and Staff’s proposed revision in tariff language provides the same opportunity to update the factor with a showing of evidence as would be necessary in a separate proceeding.~~

~~Including Staff's proposed language in the tariff, Staff asserts, only makes clear that this factor may need to be updated if circumstances warrant.~~

~~Staff sets out its proposed language for Section H Annual Reconciliation to be modified as follows:~~

~~ActSav= Actual savings, which is determined as \$6,000.00 times the actual number of miles of cast iron and ductile iron main abandoned in the reconciliation year. The Company shall update ActSav no less than every three years. The first such update shall be required in the Company's third annual reconciliation proceeding, but may be updated sooner if demonstrated to be necessary by the Company or any other party. Staff Exhibit 1.0 at 44 (omitting language for withdrawn tenth recommendation).~~

~~To require a separate proceeding, in Staff's view, places an unnecessary burden on both the Commission and the parties. While we understand Staff's position, we know of no way to bring a "demonstration" of necessity of any kind to the Commission without the initiation of a formal proceeding. This may be an inconvenience, but it is the only way that the Commission is able to authorize a change to what it has already established by order. In the end, this is an important protection against arbitrary action and extends to all parties alike. For these reasons, Staff's recommendation in this instance is accepted in part and rejected in part. The phrase, "but may be updated sooner if demonstrated to be necessary by the Company or any party" will be stricken.~~

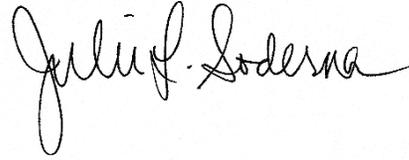
~~We further observe that the Company contests Staff's "ninth" recommendation, i.e., that no charges under Rider ICR be made until the Company's plan for its proposed accelerated infrastructure replacement program, as recommended by Staff witness Stoller, is approved by the Commission. Apparently, the Company strongly opposes Staff witness Stoller's recommendation that the Commission must first approve the Company's accelerated infrastructure replacement plan. And for this reason, the Company opposes Staff witness Hathhorn's recommendation. This tells the Commission that we must stop at this point in our evaluation and carry our assessment of Rider ICR into the next section of this order where we will consider Mr. Stollar's proposals.~~

**WHEREFORE**, for these reasons and those stated in CUB's Initial Brief, CUB respectfully requests that the Commission reject Rider ICR and modify the Proposed Order as set out above:

Respectfully submitted,

CITIZENS UTILITY BOARD

Dated: November 24, 2009

A handwritten signature in black ink that reads "Julie L. Soderna". The signature is written in a cursive style with a large, looping initial "J".

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