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)	)	

BRIEF ON EXCEPTIONS AND EXCEPTIONS OF THE PEOPLE OF THE STATE OF ILLINOIS

THE PEOPLE OF THE STATE OF ILLINOIS

by LISA MADIGAN, Attorney General

Janice Dale,
Chief, Public Utilities Bureau
Karen Lusson
Senior Assistant Attorney General
Public Utilities Bureau
Kristin Munsch
Assistant Attorney General
Office of the Attorney General
100 West Randolph Street, 11th Floor
Chicago, Illinois 60601
Telephone: (312) 814-1136
Fax: (312) 814-3212

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I. INTRODUCTION

NOW COME the People of the State of Illinois ("the People"), by Lisa Madigan, Attorney General of the State of Illinois, and pursuant to Part 200.830 of the Illinois Commerce Commission's ("the Commission") rules, 83 Ill.Admin.Code Part 200.830, hereby file these exceptions to the November 6, 2009 Proposed Order ("Proposed Order") issued by the Administrative Law Judges in the instant docket, a general increase in rates and request for rider treatment of infrastructure investment proposed by the Peoples Gas Light & Coke Company ("Peoples" "PGL" or "the Company") and North Shore Gas Company ("North Shore") (collectively "the Companies").

* * *

"A Commission Order is a powerful document." Proposed Order of November 6, 2009 at 166. The People could not agree more. It is crucial that a recommendation to the Commission in the form of a Proposed Order accurately, comprehensively and fairly evaluates the evidence and applicable law. There are several items to which the People take exception as set forth below.

The strongest and most significant areas of disagreement are with respect to its recommendation to approve Rider ICR. The Proposed Order presented for review in this case does nothing to ensure the integrity of Peoples' infrastructure. It confuses a rider – which is a revenue recovery mechanism – with a commitment or plan to accelerate main replacement. It is neither.

In its approval of PGL's requested Rider ICR, the November 6, 2009 Proposed Order ignores *uncontroverted* evidence that:

- Peoples conducted no financial projections to quantify the extent to which Rider ICR is needed from a financial perspective in order to finance any rate of acceleration of main replacement[1];

- the Rider ICR proposal in no way obligates PGL to replace its cast iron main at even its current average rate of replacement, let alone at an accelerated pace;

- PGL not only has no specific plan for acceleration, but it plans to *decrease* investment in main replacement in the foreseeable future[2]; and

- Rider ICR is triggered with the first dollar of investment, and rewards the Company with monthly customer surcharges for even slower than normal rates of main replacement, even though the Company has been replacing main since 1983 on an accelerated basis without a rider.

Rider ICR in no way obligates PGL to replace its cast iron main at even its current average rate of replacement, let alone at an accelerated pace. Peoples did not present any evidence of a specific plan for replacement acceleration; rather, the Company testified it plans to *decrease* investment in main replacement in the foreseeable future. Most importantly, Peoples presented no financial projections demonstrating why a cost recovery mechanism such as Rider ICR would be needed to undertake a replacement acceleration program.

PGL has been explicit about the rationale behind its request: PGL is not asking for Commission approval of a main replacement acceleration program. It is asking only for Commission approval of a cost recovery tool for such a program, regardless of what rate of cast iron/ductile iron main replacement occurs. While the Commission must concern itself with protecting the public's interest in the maintenance of reliable and affordable utility service, including any modernization deemed necessary, the adoption of Rider ICR cannot help the Commission do so. If the Proposed Order's recommendation is adopted

[1] ICC Staff Ex. 8.0, Attachment B, p. 5; AG/CUB Ex. 3.03 (Rubin Direct) (PGL/NS response to AG data request 1.05).
[2] NS-PGL Ex. ED-2.0 at 5 (Doerk Rebuttal).

by the Commission, its only certain accomplishment will be to trigger monthly surcharges on customer bills without any guarantee that the acceleration or job creation the ALJs desire will ever occur.

The regulatory bargain which protects both the utility and consumers requires that a utility finance its infrastructure investment through internally generated funds or through the capital markets so that customers pay only for infrastructure investment deemed prudent and in-service at the time of the next rate case. The Proposed Order fails to address the key policy question raised by the Rider ICR proposal: should the regulatory bargain that has been in place for 100 years be abandoned by approving Rider ICR? Instead, the ALJs cavalierly conclude that "[a]ll 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." Such a conclusion is belied by the fact that PGL is unwilling to commit to any particular infrastructure program – including a main replacement acceleration program – and PGL has not presented any evidence whatsoever of financial need for a rider.

If the Commission concludes that acceleration of Peoples' existing main replacement schedule is appropriate based on the evidence presented, the Commission should adopt Staff's recommendation to order the Company to hire an independent consultant to assess and monitor a specific acceleration plan that includes specific commitments and benchmarks, as well as evidence that the City of Chicago can muster the resources needed to keep pace with any utility plan for acceleration.

The People take exception as well to the Proposed Order's recommended findings regarding the Companies' revenues based on their sales revenue projections; Account

904 Uncollectibles Expenses and the Companies' customer charges for service classifications Nos. 1 and 2. The People request oral argument on the issue of Rider ICR for the reasons described in Exception X *infra*.

EXCEPTION NO. 1:

THE PROPOSED ORDER'S ADOPTION OF RIDER ICR IGNORES CRITICAL EVIDENCE, OMITS ANY EVALUATION OF CRUCIAL POINTS RAISED BY STAFF AND THE AG, AND MISINTERPRETS ILLINOIS LAW REGARDING WHEN RIDERS ARE PERMISSIBLE.

A. The Proposed Order Never Addresses People's Failure to Show A Need For Rider ICR.

It is worth restating that under Illinois law, a utility bears the burden of proving that proposed changes in rates are just and reasonable. 220 ILCS 5/9-201(c). Here, Peoples Gas had an obligation to demonstrate that its proposed Rider ICR – which would completely alter the way the Company finances infrastructure investments and the timing of when ratepayers pay for them, *as well as increase rates* each month over and above the levels authorized in this Order – was, in fact, needed, just like any other rate increase request. Rather than financing plant through internally generated funds and debt and then earning a return on that used and useful investment after filing a rate case, Peoples' proposal would force ratepayers to pay a return of and on forecasted distribution plant investment up front at a rate of Peoples' choosing without the synchronized, balanced review of all elements of the revenue requirement -- a key component of traditional regulation that is missing when riders are used to recover designated expenses. Financing plant in this manner would necessitate a drastic departure from past regulatory

practice. While the Commission's decisions are not res judicata, where the Commission's decisions drastically depart from past practices, they are entitled to less deference. *Business & Professional Peoples for the Public Interest v. Illinois Commerce Comm'n,* 136 Ill.2d 192, 228 (1989).

Given the radical departure in financing plant investment that the proposed Rider ICR would engender, the Company had a legal burden of proving that this unorthodox ratemaking mechanism is both permitted under law and, in fact, necessary from a financial perspective. The Proposed Order, however, confuses approval of Rider ICR proposal with approval of a specific plan for accelerated main replacement, and wrongly concludes that the Commission's last People Gas rate order in ICC Docket No. 07-0241, 07-0242 paves the way for adoption of Rider ICR in this case. PO at 167. In doing so, the Proposed Order both mischaracterizes and ignores crucial evidence in the record, and pieces together a legal analysis of rider law that cannot be relied upon by the Commission.

It is first critical to understand, and the Proposed Order never addresses this point, that the Company's proposed Rider ICR would *not* create monthly surcharges for only accelerated main replacement investments over and above typical annual investment amounts. Tr. 58; 161-162. As the People emphasized in their briefs, Rider ICR would assess surcharges *for the first dollar invested* in the following accounts: 1) distribution mains; 2) measuring and regulating station equipment, general; 3) measuring and regulating station equipment, City Gate check stations; 4) services; and a percentage of

forecasted investments in 5) meters, including meter installations; and 6) house regulators.[3] PGL. Ex. VG-1.1 at 89 of 120.

Given the clear sea change in the way Peoples would be financing its infrastructure investment under Rider ICR, it was incumbent upon the Company to prove a need for the monthly surcharges. The record evidence, however, showed no such need existed. In its direct testimony, the only statement that addresses the alleged need for a special rider is PGL witness James Schott's statement that "the financial crisis has made capital more expensive to obtain. This makes the need for rider treatment, with the greater level of certainty of recovery on and of the investment in cast iron main, even more critical to keep the capital costs associated with the infrastructure improvement reasonable." PGL Ex. JFS-1.0 at 14.

Given this paltry evidence in support of Rider ICR, both Staff and the AG propounded numerous discovery questions exploring the Company's alleged need for financing plant investment through Rider ICR. AG/CUB witness Scott Rubin, as well as Staff witnesses Sheena Kight-Garlisch and Peter Lazare, all agreed the Company failed to prove that Rider ICR is needed or appropriate, and attached these critical responses as exhibits to their testimony. Those responses showed the following:

- Peoples conducted no research nor developed any financial projections to quantify the extent to which its proposed Rider ICR was needed from a financial perspective in order to mitigate future earnings attrition. ICC Staff Ex. 8.0 (Kight-Garlisch Direct), Attachment B, p.5. (Attached to this Brief as Appendix A.)

[3] These accounts include a myriad of expense categories that would be capitalized under Rider ICR. For example, Services (Account 380) would include "curb valves and curb boxes; excavation including shoring, bracing, bridging, pumping, backfill and disposal of excess excavated material; landscaping including lawns and shrubbery; municipal inspection; pavement disturbed including cutting and replacing pavement, pavement base and sidewalks; permits; pipe and fittings including saddle…or other fitting on the street; pipe coding; pipelining; protection of street openings; service drips; service valves at head of service when installed or furnished by the utility." Tr. at 659. *See,* gen'ly Tr. at 656-662.

- The Company's lone witness testifying about the alleged need for Rider ICR, Mr. Schott, had no analysis in his possession that compares the cost to finance the infrastructure replacement program with and without Rider ICR. ICC Staff Ex. 8.0, Attachment B, p. 7. (Attached to this Brief as Appendix B.)

- Neither the Company nor any outside consultant conducted any analysis that showed that Peoples would be unable to earn its authorized return if it adopts an accelerated main replacement program under traditional regulation, without a rider. ICC Staff Ex. 8.0, Attachment B, p. 6; AG/CUB Ex. 3.02 (Rubin Direct). (Attached to this Brief as Appendix C.)

- When asked to what extent Peoples does *not* expend its resources on plant replacement or reliability enhancement projects that are otherwise economically justified and needed because of concerns about delayed rate recovery in the absence of Rider ICR, Peoples responded that "it expends all necessary resources on plant replacement and reliability enhancement projects required to provide safe reliable service" and that "[t]here are no plant replacement projects that meet these criteria that were not undertaken because of rate recovery considerations." AG/CUB Ex. 3.04 (Rubin Direct). (Attached to this Brief as Appendix D.)

- Peoples stated unequivocally in response to data requests that the absence of an automatic rate adjustment rider for capital costs has not affected the Company's access to capital. AG/CUB Ex. 3.04.

- Peoples continues to have access to capital markets for main replacement, and there are no needed capital projects in the past three years that could not be funded due to limited access to capital markets on reasonable terms. AG/CUB Ex. 3.05. (Attached to this Brief as Appendix E.)

Staff witness Kight-Garlisch testified that the Company provided no analysis to support its need for Rider ICR to raise sufficient capital to provide adequate, efficient, reliable and safe utility service at a reasonable cost. ICC Staff Ex. 8.0 at 22. Staff witness Peter Lazare was particularly critical of Mr. Schott's assertion that Rider ICR would somehow "keep the capital costs associated with the infrastructure improvement reasonable." PGL Ex. JS-1.0 at 14. Mr. Lazare noted that Mr. Schott provided no specific evidence concerning what the capital costs for the program would be with and

without Rider ICR. ICC Staff Ex. 9.0 at 4. The Company's responses to various Staff and AG data requests, as noted above, confirmed this fact.

Staff witness Lazare particularly highlighted this defect in the Company's evidentiary presentation, noting that the need for main replacement acceleration and how such a program should be funded are two distinct questions:

> It is not clear how Mr. Marano's testimony supports the adoption of a rider to collect infrastructure costs. He focuses instead on the need for an accelerated program to replace the current network of cast iron and ductile iron mains and how that can best be accomplished. However, he does not discuss why a rider mechanism is needed to recover the associated costs. Mr. Marano is clear on this matter. … Mr. Marano states the 'analysis of regulatory mechanisms to allow companies to be recover their costs of system modernization as well as to flow reduced system costs back to customers' is presented by Company witnesses Schott and Grace.

ICC Staff Ex. 9.0 at 4.

Mr. Lazare noted that "even if an accelerated program can be supported, that does not provide a compelling case for a rider mechanism." *Id.* at 5. He added that "(t)he normal mechanism for recovering infrastructure investments of any kind is base rates and if an alternative approach were necessary, the Company would have to argue accordingly." *Id.* He concluded that only after a specific accelerated main replacement program implementation plan was presented could the Commission properly assess whether adoption of an extraordinary rider recovery mechanism was appropriate. *Id.* at 6.

AG/CUB witness Scott Rubin, like Staff witnesses Lazare and Kight-Garlisch, similarly concluded that Peoples failed to make a case for Rider ICR adoption. Mr. Rubin testified that Peoples failed to show 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. AG/CUB Ex. 3.0 at 4-5.

AG/CUB witness Rubin provided further support for rejection of Rider ICR and retention of the traditional method of financing capital investments. He noted that riders are particularly inappropriate to use for the recovery of capital costs related to new infrastructure investment. He explained that utility rates are set based on a synchronized examination of all aspects of the utility's costs of service and sources of revenue, as well as other considerations such as the quality of service and efficiency of management, and that such synchronization is the reason why a test year is used in ratemaking. AG/CUB Ex. 3.0 at 5. The synchronization of adding new investment also requires adjustments to rate base, depreciation expense, other O&M expenses, working capital and taxes. *Id.* But the use of riders for only certain aspects of a company's revenue requirement violates the matching principle "and helps to destroy the underlying relationship between utility rates and levels of cost and investment." *Id.* at 6.

The Company's failure to show a need for Rider ICR, however, is completely overlooked in the Proposed Order. In their analysis of the evidence, the ALJs referenced page 162 of the Commission's prior Order in the Companies' last rate case, ICC Docket Nos. 07-0241, 07-0242 ("2008 Peoples Order"), and surmised: "Altogether, we set out six standards. And, these are the very standards by which the Commission will evaluate the Company's proposed Rider ICR." PO at 167. The Proposed Order's analysis of the evidence through the prism of these "standards" relies almost completely on the testimony of PGL witness Salvatore Marano for their decision to approve Rider ICR. PO at 161-171. The testimony of Mr. Marano, an outside consultant who testified that

acceleration of main replacement, with a preferred completion date of *2030*, would save Peoples Gas a total of $244 million from the years 2011 through 2059, was the Company's response to the six "standards" referenced in the prior Order. Mr. Marano himself, however, admitted that his analysis did not consider whether a rider is an appropriate cost recovery mechanism. Tr. at 855, 842-843. And an examination of the cross-examination of Mr. Marano, highlighted in the AG Initial and Reply briefs, revealed that his analysis was little more than a general endorsement of the time value of money. *See* AG Initial Brief at 28-34; AG Reply Brief at 10-13.

Moreover, a careful review of the 07-0241/07-0242 Order, reveals that the template for the Rider ICR analysis was not limited to satisfying these six criteria. The Commission specifically recognized in this Order that rider requests for infrastructure investment possess a core legal infirmity: 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 stated:

> 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 Commission went on to reject a similar rider proposal, and noted that "Insofar as Peoples Gas would like to quicken the pace of system modernization, it is free to craft a concrete and sustainable proposal for doing so, and to request base rate recognition of associated investments." *Id.* at 161. The Commission then went on to state, at page 162, that the Company's Rider ICR proposal "reflects a need for the Commission to provide guidance to utilities on the information the Commission needs, *at a minimum*, to evaluate system modernization proposals, beyond

Part 656 and Section 220.2 of the Act." *Id.* at 162. The Proposed Order fails to explain how the Rider ICR proposed in this docket somehow, now, is "not the subject of routine, traditional Commission ratemaking." *Id.*

Commission approval of Rider ICR, as recommended by the Proposed Order, would fundamentally alter how Peoples Gas funds the maintenance of its gas delivery system infrastructure, shelving 100 years of regulatory practice and altering the regulatory compact that exists between the utility and regulators. The Company failed to provide even a scintilla of specific evidence that such a sea change in infrastructure financing and ratemaking is needed and appropriate. The Commission's Final Order should reflect that fact and reject Rider ICR.

B. The Proposed Order's Analysis of the What Evidence is Needed to Justify Rider ICR is Inconsistent with the Commission's Recent Decision in the Nicor Rate Case.

At page 172, the Proposed Order criticizes the AG's reference to the Commission's recent rejection of an infrastructure rider proposal in the recent Nicor rate case, ICC Docket No. 08-0363, as a basis for similarly rejecting the PGL rider. Like Peoples' proposal, the Nicor proposed rider was proposed as a means to accelerate the rate of cast iron main replacement in the utility's gas distribution system. Unlike Peoples' proposal, however, which would generate rider surcharges with the first dollar of investment in the six identified plant accounts, the Nicor rider would have only generated surcharges on main replacement activity over and above the first 15 miles of main investment made. Nicor Order at 168. The Proposed Order opines that the Commission rejected the Nicor rider because the Company failed to the aforementioned

standards identified in the 2008 Peoples Gas rate order. Proposed Order at 172. However, the Proposed Order's selective analysis of that Order ignores one crucial fact: the Commission also specifically found therein that "Nicor did not meet its burden of proof to provide facts *establishing the need for this Rider*…" Nicor Order, ICC Docket No. 08-0363 at 170 (emphasis supplied).

It is noteworthy, too, that the Commission was particularly critical of Nicor's evidentiary presentation, noting that "what Nicor has proven, at best, is only that Rider QIP would allow Nicor to better keep pace with the declining performance of the materials in question. It has provided us with no reason to impose the additional cost of 'better keeping pace' upon ratepayers, many of whom are, as Nicor has acknowledged, facing difficult financial times." *Id.*

Clearly, the Commission sought evidence of a financial need for a rider from Nicor, and rejected the proposed rider when such evidence was not presented by the company. The similar lack of evidence in the instant Peoples case is, in fact, more glaring. Not only did the Company fail to demonstrate a need for a rider, its responses to Staff and Intervenor discovery questions on the matter affirmatively showed that, in fact, the Company admits it has not been and is not in need of special rider financing of infrastructure investments, accelerated or otherwise. *See* part A *infra.*

The Commission should reject the Proposed Order's inconsistent analysis of utility infrastructure rider proposals, as compared with the Nicor order, and reject PGL's proposed Rider ICR. Consistent analysis of PGL's Rider ICR proposal demands outright rejection of this unorthodox and unneeded revenue recovery mechanism.

C. The Proposed Order Confuses and Equates PGL's Proposed Rider ICR With a Commitment to Accelerate Main Replacement.

Upon close examination of the Proposed Order, it becomes clear that the Proposed Order confused approval of Rider ICR with a specific commitment to accelerate main replacement. This is the critical error in the Proposed Order's framing of the Company's proposal. The question presented in this docket, as proposed by Peoples, was *not* whether acceleration should occur, but *whether Rider ICR should be approved to finance any and all levels of main replacement.* Contrary to the Proposed Order's incorrect assessment of the AG's position in this case (the only thing that the AG and CUB press for, is maintaining the *status quo")*[4], no party argued against the acceleration of main replacement. Yes, the People specifically argued that Rider ICR should be rejected, for all of the reasons mentioned above and in the AG's Initial and Reply briefs (AG Initial Brief at 19-47; AG Reply Brief at 8-21). But the People further recommended that the Commission should open another docket to establish a plan for Peoples' main replacement that balances safety, efficiency and affordability of rates. AG Initial Brief at 66-67. This recommendation can hardly be deemed a desire for the status quo.

A careful reading of the Proposed Order, however, makes clear that the Proposed Order missed the critical distinction between justifying a case for acceleration, which was the admitted purpose of the Marano testimony, and making a case for a rider. The Proposed Order is written in a way that suggests that Commission approval of Rider ICR will somehow cause Peoples to replace cast iron main at a level over and above its current rate, and indeed even create new jobs. Several statements in the Rider ICR "Commission Analysis and Conclusion" section betray this confusion:

[4] Proposed Order at 173.

- "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." PO at 172 (emphasis supplied).

- "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."* PO at 173 (emphasis supplied).

- "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.* PO at 173.

- 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.* PO at 173 (emphasis supplied).

- "The testimony of Mr. Marano demonstrates for us that *the Company's proposal* serves these interests as well." PO at 174 (emphasis supplied).

.

- We find on the entirety of this record in this case, that *Rider ICR 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).* PO at 180 (emphasis supplied).

- "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 (sic) does not actually opposes (sic) the 5% cap but that this is another way to press its opposition to accelerated main replacement." PO at 180-181.

As noted above, referenced throughout the Proposed Order's analysis is the phrase "the Company's proposal." What the Proposed Order ignores, however, is that "the Company's proposal" in this docket did not include acceleration or approval of a specific plan, best clarified by Mr. Schott, again, during cross-examination and reiterated in the PGL briefs:

> Q. Let me rephrase the question. Is it the Company's position that if an accelerated infrastructure program is approved, along the linings (sic) that the Company seeks, in other words a completion date of *2030*; is that correct?
>
> A. 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.

Rider ICR is not, and never has been, a plan for acceleration. The record evidence shows that the Company plans to slow its rate of main replacement, not increase it. Nevertheless, PGL comes before this Commission asking for the right to assess monthly surcharges for less than the average rate of main replacement, and the Proposed Order acquiesces to that request.

Ironically, approval of Rider ICR does nothing to maintain the integrity of the PGL distribution system, as revealed in one simple colloquy between PGL's chief Rider ICR witness James Schott, Vice President of Regulatory Affairs for Integrys Energy Group, Peoples Gas and North Shore, and counsel for the People:

> **Q.** But approval of the rider, in and of itself, would not necessarily dictate the pace or, in fact, whether or not the acceleration would occur; is that correct?
>
> **A.** That's correct.

Tr. at 61.

While the Marano testimony envisioned a preferred acceleration completion date for purposes of demonstrating the time value of money, the Company is in no position to achieve that timeline. The Proposed Order brushes off certain facts about Mr. Marano's analysis and any assumption that a *2030* completion date is a realistic goal, pointed out in the AG briefs. For example, Mr. Marano testified that he rejected adoption of a 2025 completion date because "replacing 154 miles of main per year is more than three times the current replacement rate and deemed not practical" in his opinion. PGL Ex. SDM-1.0 at 50. Indeed, Mr. Marano's direct testimony stated that his preferred acceleration plan would require the then replacement rate of 45 miles-per-year to more than double. PGL Ex. SDM-1.0 at 72. Adoption of Mr. Marano's *2030* completion date, however, would require Peoples to step up main replacement from the forecasted 10 miles per year to 114 miles per year, or *more than 11 times* the amount replaced in forecasted 2010. Tr. at 831-833. Neither Mr. Marano nor the Company explains how it will address that hurdle. Again, they don't address the issue because there is no specific plan to accelerate. The Proposed Order, however, characterizes this point as "an internal working matter" that can be addressed with the hiring of more workers. PO at 172.

The *2030* timeline, upon which the cost/benefit analysis rests, is unrealistic from a revenue requirements perspective. Mr. Rubin presented uncontroverted evidence that following that timeline would require ratepayers to more than $3 billion more than they

would under the existing main replacement schedule that ends in 2059. *See* AG Initial Brief at 34-37. The fact that PGL did not dispute that analysis is overlooked by the ALJs.

The Proposed Order further asserts that job creation "is one of the economic benefits of acceleration and the reality is that it could not be coming at more (sic) opportune time." PO at 172. Here again, however, the Proposed Order confuses approval of Rider ICR with a specific plan for acceleration and job creation. What rate of replacement does the Proposed Order assume will occur with Rider ICR? How many Union and contract workers will the Company hire with Rider ICR? The ALJs don't know because Rider ICR does not in any way guarantee that either acceleration or hiring will occur. The only thing the Proposed Order's approval of Rider ICR guarantees is that ratepayers will be charged more for the Company doing less, given the Company's infrastructure investment forecasts and the fact that the tariff surcharges are triggered with the first dollar of investment.

D. The Proposed Order's Criticism of AG/CUB Witness Rubin's Revenue Requirement Analysis Ignores the Fact that it was Uncontroverted.

In his rebuttal testimony, AG/CUB witness Rubin provided uncontroverted evidence that adoption of Mr. Marano's preferred *2030* main replacement completion date would cost ratepayers in excess of $3 billion more than under the current main replacement schedule. AG/CUB 6.0 at 6; AG Initial Brief at 34-36. Mr. Rubin performed the analysis to demonstrate that the *2030* date relied upon by Mr. Marano to support his conclusion that acceleration would save the Company money has real, significant effect on the rates PGL's customers would pay if adopted. It also diminishes

the viability of Mr. Marano's net cost/benefit figures, which rely on the *2030* completion date.

At page 171, however, the Proposed Order, accepts without explanation the Company's strawman responses to Mr. Rubin's analysis offered by the Company to obfuscate this ratemaking reality. The Proposed Order opines that "the respective testimonies of Company witness Grace, Schott and Marano … 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." *Id.* Without explaining why, the Proposed Order concludes, "We view this (Rubin) analysis as incomplete, sparse on narrative support, and unable to stand on its moorings." PO at 171.

These PGL criticisms, wholly adopted by the Proposed Order, were nothing more than smoke and mirrors. AG Reply Brief at 13-17. In fact, Mr. Schott confirmed during cross-examination that Mr. Rubin's revenue requirements analysis was correct. 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 *2030* 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. When specifically asked whether any other changes should be made to the Rubin analysis, Mr. Schott answered, "No." Tr. at 70.

The other PGL criticism accepted in the Proposed Order -- that Mr. Rubin's revenue requirement analysis does not accurately show what customers would pay under Rider ICR -- is likewise a strawman for a couple of reasons, as explained in the AG's Reply Brief. 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 *2030* completion date was adopted. Mr. Rubin's analysis – the only examination in the case of the revenue requirement implications of a *2030* 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 Initial Brief at 34-36.

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 strawman argument designed to confuse the Commission, but nevertheless endorsed in the Proposed Order.

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 *2030* acceleration that Mr. Marano admitted he omitted 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 *2030* 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. This was the very point of Mr. Schott's criticism that the Rubin analysis needed only to add in rate case expense to be completely accurate. Mr. Rubin never stated these revenue requirement amounts would be recovered under Rider ICR. Rather, the analysis shows the impact of a *2030* acceleration deadline on customers from an annual revenue requirements perspective – not the impact of Rider ICR annually, as the Company asserts and the Proposed Order so willingly accepts.

In sum, the Proposed Order misunderstands Mr. Rubin's examination of the revenue requirement effect of the Marano-recommended acceleration date. As noted above, Peoples did *not* dispute the validity of the numbers presented by Mr. Rubin. Mr. Rubin's analysis – the only examination in the record of Mr. Marano's flawed calculation of the savings associated with acceleration -- simply exposed the Marano analysis for what it was: a simplistic, general examination of the time value of money under specific assumptions regarding inflation, materials and wage rates that, if used as a basis for requiring a *2030* completion date, would wallop ratepayers with ever-growing Rider ICR charges and nearly annual rate cases. As the People noted in their Reply Brief, the Commission is obligated to examine how the *2030* acceleration completion date selected in the Marano cost/benefit analysis would affect customer rates, especially when that recommended timeline has nothing to do with public safety or actual replacement need, but rather the time value of money. The criticism of Mr. Rubin's analysis in the

Proposed Order is misplaced and unexplained, and should not be incorporated in the Commission's final order.

E. The Proposed Order's Analysis of Relevant Illinois Case Law On When Riders Are Appropriate To Recover Specific Expenses Is Wrong and Not Legally Sustainable.

The Proposed Order's summation of Illinois law on when riders are permissible suggests that Commission authority to approve rider recovery of expenses is nearly limitless, as long as the Commission declares them "appropriate circumstances." PO at 176. In fact, the authority is narrow and circumscribed. As noted at pages 37-41 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, fall 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 (1995). As noted above, the Commission itself 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 Proposed Order, however, accepts PGL's argument that there are no legal and regulatory barriers to Commission approval of Rider ICR. PO at 176-180. The Proposed Order first concludes that the Public Utilities Act's prohibition against single-issue ratemaking does not apply here because the Company included a $6,000 per mile offset in the Rider ICR tariff that will be re-calculated every three years. PO at 176-177. 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 ALJs say 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 overall expenses and savings reflected in a test year scenario will be reflected in that forecasted estimate. In addition, Mr. Marano admitted during cross that the $6,000 savings estimate to be incorporated into Rider ICR did not include all "synergies" that might occur as a result of acceleration of main replacement. Tr. at 845. He admitted, "So there's opportunities for significant savings that weren't factored in." *Id.* The fact that the $6,000 figure can be revisited every few years 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).

To be clear, the prohibition against single-issue ratemaking is not solved by forecasting operational savings that may be achieved as a result of main replacement. The rule against single-issue ratemaking recognizes that rates shall be set by considering costs and earnings *in the aggregate*, where potential changes in one or more items of

expense or revenue may be offset by increases or decreases in other such items. PGL's Rider ICR proposal considers changes in infrastructure investment in isolation, ignoring the totality of circumstances and thereby constituting illegal single-issue ratemaking. Rider ICR ignores the traditional ratemaking process, which employs a balanced review of jurisdictional expenses, rate base investment, and the cost of capital and revenues at present rates during the test year. If approved, Rider ICR would violate the Act's prohibition against single-issue ratemaking by imposing a surcharge each month on customers' bills based on forecasted levels of infrastructure investment for the coming year, without examining whether the Company's overall cost of service and revenue requirement have increased.

In order to avoid single-issue ratemaking violations, expenses proposed for rider recovery must fit specific judicially and legislatively defined categories. The instant Rider ICR proposal would recover expenses associated with financing main gas distribution infrastructure replacement from the first dollar of investment. Maintaining and replacing mains is a principal function of a gas distribution utility, and involves 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. Depreciation and capital costs, which would be recovered under Rider ICR, fit none of the expense category exceptions permitted under Illinois law.

Contrary to the Proposed Order's liberal and erroneous reading of rider case law, the circumstances that warrant rider treatment are narrow and limited. All riders are "closely scrutinized because of the danger of single-issue ratemaking," which is

"prohibited because it considers changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement." *City of Chicago v. Illinois Commerce Comm'n,* 281 Ill.App.3d 617, 627 (1st Dist. 1996). Illinois courts have allowed the use of riders to recover "unexpected, volatile or fluctuating expenses" that by their nature do not lend themselves to representative sampling in a single test year. *Citizens Utility Bd. v. Ill. Commerce Comm'n* (*Citizens Util. Bd.),* 166 Ill. 2d 111, 138-139, 651 N.E.2d 1089 (1995) (rider appropriate for recovery of "uncertain and variable" expenses associated with coal-tar cleanup remediation required by federal statute); *see also A. Finkl & Sons Co. v. Ill. Commerce Comm'n*, 250 Ill. App. 3d 317, 327, 620 N.E.2d 1141 (1st Dist. 1993) ("Riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses.") (emphasis in original); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago II),* 264 Ill. App. 3d 403, 405, 636 N.E.2d 704 (1st Dist. 1993) (rider appropriate "for recovery of costs that are uncertain in duration, timing or amount"); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago I),* 13 Ill. 2d 607, 150 N.E.2d 776 (1958) (accepting rider to accommodate fluctuating wholesale rates for natural gas).[5]

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[5] Illinois courts have permitted riders to recover such pass-through cost items as expenses or fees required by statute or ordinance to all ratepayers or a subset of customers. *See Citizens Util. Bd.,* 166 Ill.2d at 138-139*; City of Chicago v. Illinois Commerce Comm'n,* 281 Ill. App. 3d 617, 627 (1st. Dist. 1996) (*City of Chicago III)* (rider recovery of franchise fees to be charged to residents of municipalities assessing the fees did not constitute single-issue ratemaking). *See City of Chicago II*, 264 Ill. App. 3d at 410 ("Rider 28 allows Edison to look to those who cause costs to pay for them.""")

Statutorily, the Public Utilities Act provides only a few exceptions for utility cost recovery outside of rate case proceedings. *See, e.g.,* 220 ILCS 5/9-220(a) (2008), 220 ILCS 5/9-220.1 (2008), 220 ILCS 5/9-220.2 (authorizing surcharges for fuel, environmental remediation, and water and sewage infrastructure costs). More recently, the Legislature authorized rider recovery of energy efficiency program expenses (220 ILCS 5/8-103(e), 220 ILCS 5/8-104(e)) and incremental bad debt (220 ILCS 5/19-145).

The Proposed Order takes the standards outlined in the *Finkl* and 1995 *Citizens Utility Board* and jumps to the illogical conclusion, citing *Citizens Utility Board*, 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 tacking costs and matching such costs with recoveries than would base rate recovery methods.' " PO at 177. This declaration completely misses the mark because it ignores the facts underlying the *Citizens Utility Board* case and the fact that the Court specifically distinguished between expenses that are imposed on the utility by federal and state law (such as the coal tar clean-ups costs at issue in the case) and expenditures that involve management choice and discretion as to whether to incur the expenses (such as infrastructure replacement expenses). *Citizens Utility Board*, 166 Ill.2d at 129. Ultimately, the Court concluded that environmental remediation expenditures were recoverable in full because expenses commonly incurred to comply with the mandate of federal and state law have historically been recoverable from ratepayers. *Id.* at 122-123. In its reversal of the Commission's order to permit some sharing between ratepayers and shareholders of these expenses, the Court distinguished between expenses that were previously shared, such as costs associated with rate case expense and the cost of construction associated with a cancelled plant, which "involve management choice and discretion whether to incur the expenses" and expenses imposed on the utility by federal and state law, which the Court concluded were recoverable in full from ratepayers. *Id.* at 129.

The evidence shows unequivocally that the both the timing and level of expenses associated with replacing CI/DI main would be within management's control, and thus do

not qualify as expenses eligible for rider recovery based on the *Citizens Utility Board* holding. The Proposed Order's suggestion that the AG believes these expenses are variable (PO at 177) is misplaced and indefensible. These expenses are only variable to the extent that Peoples decides to vary them, as evidenced by its updated forecasts of main replacement in this record. Main replacement expenses are not like franchise fees, or coal tar clean-up expenses or the costs of purchased natural gas, which are expenses outside of utility management's control. The conclusion that the rule against single-issue ratemaking is not a bar to adoption of Rider ICR is simply wrong.

The Proposed Order next addresses the AG's argument that Rider ICR violates the prohibition against retroactive ratemaking. Section 9-201 of the Public Utilities Act ensures that rates for utility service are set prospectively. 220 ILCS 5/ 9-201. The Illinois Supreme Court has held repeatedly that the Public Utilities Act does not permit retroactive ratemaking; that is 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. *BPI I,* 136 Ill.2d at 209; *Citizens Utilities Co. v. Illinois Commerce Comm'n,* 124 Ill. 2d 195, 207; 529 N.E.2d 510 (1988).

Contrary to the conclusion in the Proposed Order, PGL's proposed rider ICR violates the prohibition in the Act against retroactive ratemaking. Rider ICR would generate monthly surcharges based on a forecasted level of investment in six plant accounts for a particular 12-month period. PGL Ex. VG-1.0 at 35-36. A retroactive adjustment of customer rates would occur in an annual reconciliation proceeding. *Id.* at 36. This retroactive adjustment of rates is not unlike the review ruled illegal in the aforementioned *Finkl* decision, wherein the Illinois Appellate Court specifically rejected

Rider 22's adjustment of rates based on a prudency review, calling it a violation of the rule against retroactive ratemaking. *Finkl*, 250 Ill.App.3d 317 at 329. The Proposed Order, however, cites *CILCO v. Illinois Commerce Comm'n*, 255 Ill.App.3d 876, 885 (Third District 1993), and concludes that the retroactive ratemaking violation cited in *Finkl* does not apply. PO at 178. Here again, however, the Proposed Order fails to analyze the expenses that were the subject of the *CILCO* Court's ruling. Like the *Citizens Utility Board* case, the *CILCO* Court addressed the question of whether coal tar clean-up expenses were appropriately recovered through a rider. Here, the Court specifically concluded that, unlike the demand side management costs at issue in *Finkl*, the costs at issue *were, in fact*, of an "unexpected, volatile or fluctuating nature so as to necessitate recovery through a rider." *CILCO*, 255 Ill.App.3d at 885. Therefore, the expenses in *CILCO* were deemed not to violate the prohibition against retroactive ratemaking.

As noted above, there is nothing unexpected, volatile or fluctuating about main replacement expenses that are completely within the Company's control. The fact that the Company slowed its main replacement rate in 2009 and forecasted 2010 demonstrates that these expenses do not share the unexpected nature of expenses that have been deemed worthy of rider recovery, but instead are expenses that are under the control of management, all else being equal.

The Proposed Order, likewise, rejects the AG's argument that Rider ICR violates the Commission's test year rules. The ALJs site the Commission's Order in the last Peoples Gas rate case and the ruling in the 1995 *Citizens Utility Board* case to suggest that test year rule violations are "simply 'not present' when expenses are recovered

through a rider." PO at 179. The Proposed Order then surmises that the "Court's ultimate assessment of the test year rules is applicable to the situation at hand" but never explains why. PO at 179. This perfunctory assessment of the case omits the fact that the Court's conclusion that a test year violation had not occurred was due to its assessment that coal tar remediation expenses fell within the category of expenses that are recoverable through a rider, in this case, expenses that were mandated by federal or state law. The Court in no way proclaimed that test year violations are never present in rider proposals.

Perhaps the most tortured portion of the legal analysis comes under the heading "Final Legal Analysis" on page 180 of the Proposed Order, wherein the ALJs cite to characteristics that make expenses recoverable through a riders and attempt to apply them to Rider ICR and main replacement:

> We find on the entirety of this record in this case, that Rider ICR 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).

PO at 180. First, Rider ICR is in no way a "unique" system needing improvement. Again, a rider is a cost recovery mechanism not a system modernization plan. Further, the evaluation of something being "unique", as referenced by Illinois courts, applies to *expenses* not gas distribution systems. Likewise, the use of the term "extraordinary" by Illinois courts applied to *expenses* not "a pressing public concern." And, as pointed out earlier in this section, a gas utility's main replacement investment expenses are within management's control, and are not subject to the kind of fluctuations that occur with, for example, the purchase of natural gas, whose costs are outside of management control, or

franchise fees, that are set by a municipality. Ultimately, the Proposed Order's attempt to characterize infrastructure investment expenses as falling within the limited categories of expenses that can be recovered through riders under Illinois law is like attempting to fit a balloon in a thimble: it simply can't be done.

In sum, the Proposed Order's analysis and application of Illinois cases involving riders should be rejected.

* * *

For all of the reasons explained above, the Commission should reject the approval of Rider ICR in the Proposed Order.

PROPOSED LANGUAGE

In accordance with the arguments presented above, the Commission should strike the entire "Commission Analysis and Conclusion" beginning at the bottom of page 165 through page 182 and replace it with the following language:

Commission Analysis and Conclusion

Under Illinois law, a utility bears the burden of proving that proposed changes in rates are just and reasonable. 220 ILCS 5/9-201(c). In this docket, Peoples' proposed Rider ICR would completely alter the way the Company finances infrastructure investments and the timing of when ratepayers pay for them. Rather than financing plant through internally generated funds and debt and then earning a return on that used and useful investment after filing a rate case, Peoples' proposal would require ratepayers to pay a return of and on forecasted distribution plant investment up front at a rate of Peoples' choosing without the synchronized, balanced review of all elements of the revenue requirement -- a key component of traditional regulation that is missing when rides are used to recover designated expenses. Financing plant in this manner would necessitate a drastic departure from past regulatory practice. While the Commission's decisions are not res judicata, where the Commission's decisions drastically depart from past practices, they are entitled to less deference. *Business & Professional Peoples for the Public Interest v. Illinois Commerce Comm'n,* 136 Ill.2d 192, 228 (1989).

Given the evidentiary hurdle necessitated by Peoples' proposed departure from past regulatory practice, Peoples efforts to justify adoption of Rider ICR

were sorely lacking. Peoples' testimony does not address the need for a special rider tariff to recover costs associated with infrastructure replacement. In its direct testimony, the only statement that addresses the alleged need for a special rider is PGL witness James Schott's statement that "the financial crisis has made capital more expensive to obtain. This makes the need for rider treatment, with the greater level of certainty of recovery on and of the investment in cast iron main, even more critical to keep the capital costs associated with the infrastructure improvement reasonable." PGL Ex. JFS-1.0 at 14.

AG/CUB witness Scott Rubin, as well as Staff witnesses Sheena Kight-Garlisch and Peter Lazare, all agreed the Company failed to prove that Rider ICR is needed or appropriate. For example, Peoples stated unequivocally in response to data requests that the absence of an automatic rate adjustment rider for capital costs has not affected the Company's access to capital. AG/CUB Ex. 3.04. Peoples also admitted in a discovery response that it has not failed to make needed investments in its system due to lack of capital or the inability to automatically recover capital costs through a rider. AG/CUB Ex. 3.05.

Ms. Kight-Garlisch testified that the Company provided no analysis to support its need for Rider ICR to raise sufficient capital to provide adequate, efficient, reliable and safe utility service at a reasonable cost. ICC Staff Ex. 8.0 at 22. Staff witness Lazare was particularly critical of Mr. Schott's assertion that Rider ICR would somehow "keep the capital costs associated with the infrastructure improvement reasonable." PGL Ex. JS-1.0 at 14. Mr. Lazare noted that Mr. Schott provided no specific evidence concerning what the capital costs for the program would be with and without Rider ICR. ICC Staff Ex. 9.0 at 4. The Company's responses to various Staff and AG data requests confirmed this fact. For example, the Company created no financial models to estimate the effects on the company's financial position, with or without Rider ICR, if it adopted an infrastructure replacement program that ended in 2030, as recommended by PGL witness Salvatore Marano. ICC Staff Ex. 8.0, Attachment B, pp. 2, 3, 7.

AG/CUB witness Scott Rubin similarly concluded that Peoples failed to make a case for Rider ICR adoption. Mr. Rubin testified that Peoples failed to show 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. AG/CUB Ex. 3.0 at 4-5. Peoples indicated in responses to AG data requests that the Company has neither conducted an analysis to determine whether Peoples would be "unable to earn its authorized return if it adopts an accelerated main replacement program under traditional regulation (without a rider)" or analyzed the impact of its proposed Rider ICR on earnings attrition. AB/CUB Exs. 3.02, 3.03.

In its rebuttal case, Peoples' response to these criticisms was to argue that "the Commission laid out a clear 'road map' or set of guidelines of its expectations of what is required for approval of such a rider", it had followed those guidelines and provided the necessary information requested therein. NS-PGL Ex. JFS-2.0 at 16. PGL witness Schott concluded: "The Staff and intervenor responses failed to identify any shortcomings in the Company's efforts

to meet the Commission's ICR guidelines. Thus, it would appear that Peoples Gas has bet the requirements outlined by the Commission in ICC Docket Nos. 07-0241/07-0242 Cons." *Id.* But even PGL witness Marano, who presented PGL's cost benefit study of accelerated main replacement, admitted that his analysis did not consider whether a rider is an appropriate cost recovery mechanism. Tr. at 855, 842-843.

PGL's cursory summation of what evidence is needed to support a Commission finding that approves rider treatment of infrastructure investment is simply wrong. In our Order in the last Peoples/North Shore rate case, the Commission rejected a similar rider proposal, and noted that "Insofar as Peoples Gas would like to quicken the pace of system modernization, it is free to craft a concrete and sustainable proposal for doing so, and to request base rate recognition of associated investments." Final Order at 161, ICC Docket Nos. 07-0241, 007-0242 ("Final Order"). The Commission also stated, at page 162, that the Company's previous Rider ICR proposal, reflects a need for the Commission to provide guidance to utilities on the information the Commission needs, *at a minimum,* to evaluate system modernization proposals, beyond Part 656 and Section 220.2 of the Act." *Id.* at 162. The Commission further stated:

> In the case of Rider ICR, the Utilities' Proposal is insufficient for the Commission to approve it. It might have been easier to approve the rider had the Utilities included, or the Staff or the Intervenors' 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.

Nothing in this language suggests that the mere presentation of a cost/benefit analysis of accelerated main replacement, and the other information delineated in this paragraph, would somehow guarantee adoption of a proposed rider, as In addition, we also found in that Order that, "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 Commission went on to reject a similar rider proposal, and noted that "Insofar as Peoples Gas would like to quicken the pace of system modernization, it is free to craft a concrete and sustainable proposal for doing so, and to request base rate recognition of associated investments." *Id.* at 161.

Staff witness Lazare particularly highlighted this defect in the Company's evidentiary presentation, noting that the need for main replacement acceleration and how such a program should be funded are two distinct questions:

> It is not clear how Mr. Marano's testimony supports the adoption of a rider to collect infrastructure costs. He focuses instead on the need for an accelerated program to replace the current network of cast iron and ductile iron mains and how that can best be accomplished. However, he does not discuss why a rider mechanism is needed to recover the associated costs. Mr. Marano is clear on this matter. … Mr. Marano states the 'analysis of regulatory mechanisms to allow companies to be recover their costs of system modernization as well as to flow reduced system costs back to customers' is presented by Company witnesses Schott and Grace.

ICC Staff Ex. 9.0 at 4. Neither Mr. Schott nor Ms. Grace provided a justification for rider treatment of future infrastructure investment. Mr. Lazare noted that "even if an accelerated program can be supported, that does not provide a compelling case for a rider mechanism." *Id.* at 5. He added that "(t)he normal mechanism for recovering infrastructure investments of any kind is base rates and if an alternative approach were necessary, the Company would have to argue accordingly." *Id.* He concluded that only after a specific accelerated main replacement program implementation plan was presented could the Commission properly assess whether adoption of an extraordinary rider recovery mechanism was appropriate. *Id.* at 6.

Finally, the Commission's recent decision in the Nicor Gas rate case supports rejection of the Company's Rider ICR proposal. In ICC Docket No. 08-0363, Nicor proposed a rider that would provide special ratemaking treatment for distribution investment above a designated base level (unlike Peoples' rider which requests special rate treatment for *all* new distribution investment in the six plant accounts). Nicor defined the base level of investment based on its historical practices, as being the replacement of 15 miles of mains and 3,500 service lines per year. It also offered to cap the total annual investment above that base amount to $20 million. Even with those restrictions, the Commission rejected the rider, stating:

> In summary, what Nicor has proven, at best, is only that Rider QIP would allow Nicor to better keep pace with the declining performance of the materials in question. It has provided us with no reason to impose the

> additional cost of "better keeping pace" upon ratepayers, many of whom are, as Nicor has acknowledged, facing difficult financial times.

ICC Docket No. 08-0363, Final Order of March 25, 2009 at 170. We also concluded that Nicor that "Nicor did not meet its burden of proof to provide facts *establishing the need for this Rider*…" Nicor Order, ICC Docket No. 08-0363 at 170 (emphasis supplied).

Like Nicor, Peoples in the instant docket failed to explain why ratepayers should be saddled with paying monthly surcharges to finance projected infrastructure investments. The Company's failure to provide any financial justification for the rider supports our rejection of the proposal.

We note, too, that while Peoples presented a cost benefit analysis of acceleration of CI/DI main replacement as support for its proposed Rider ICR, the Company has made clear throughout this case that it is *not* seeking approval by the Commission in this case of any accelerated main replacement plan. Tr. at 65-66. Mr. Schott specifically stated as such during cross-examination, and also insisted that Peoples would not commit to any certain start date on acceleration and would maintain control over the schedule of acceleration. Tr. at 61. Mr. Doerk, who oversees main replacement for the Company, concurred. Tr. at 604-606.

It is the Company's position that the current main replacement program has been managed appropriately. PGL Ex. SDM-1.0 at 28. Indeed, the Company asserted in testimony that the current main replacement schedule provides safe, reliable natural gas distribution service. PGL Ex. ED-1.0 at 13; PGL Ex. SDM-1.0 at 28. The fact that Peoples is unwilling to formally commit to a specific plan or schedule for Commission approval takes on new meaning when considered with a Rider ICR proposal that permits surcharges to be assessed on the first dollar of investment in the applicable six plant accounts.

The Company's request to approve a cost recovery mechanism before the Commission has even evaluated a specific implementation plan for any acceleration proposal is a classic case of putting the cart before the horse. As highlighted further below, what becomes clear after a review of the record evidence, including 1) the cost benefit analysis submitted by Mr. Marano; 2) the Company's refusal to commit to an acceleration plan; 3) the lack of an implementation plan; and 4) the Company's failure to assess the revenue requirement effects that a 2030 completion date would create, is that Rider ICR is *not* about creating a more modern, efficient natural gas distribution system for the City of Chicago or an implementation plan for acceleration in general. The Rider ICR proposal is about creating a vehicle for obtaining revenue for nearly *all* infrastructure investments, not just incremental increases in accelerated main replacement, between rate cases. Peoples' proposal assumes it needs a special rider in order to make *any* investment in distribution mains. There simply is nothing in the record evidence to support that notion.

We note, too, that Illinois courts have outlined specific guidelines for Commission approval of riders that limit the use of these extraordinary ratemaking mechanisms. These decisions make clear that the Commission does not have unfettered discretion to set rates through riders. Riders inherently undermine the rules against single issue and retroactive ratemaking, and they contradict the fundamental principle that rates should be based on a comprehensive test year.

The circumstances that warrant rider treatment are narrow and limited. All riders are "closely scrutinized because of the danger of single-issue ratemaking," which is "prohibited because it considers changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement." *City of Chicago v. Illinois Commerce Comm'n,* 281 Ill.App.3d 617, 627 (1st Dist. 1996). Illinois courts have allowed the use of riders to recover "unexpected, volatile or fluctuating expenses" that by their nature do not lend themselves to representative sampling in a single test year. *Citizens Utility Bd. v. Ill. Commerce Comm'n* (*Citizens Util. Bd.)*, 166 Ill. 2d 111, 138-139, 651 N.E.2d 1089 (1995) (rider appropriate for recovery of "uncertain and variable" expenses associated with coal-tar cleanup remediation required by federal statute); *see also A. Finkl & Sons Co. v. Ill. Commerce Comm'n*, 250 Ill. App. 3d 317, 327, 620 N.E.2d 1141 (1st Dist. 1993) ("Riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses.") (emphasis in original); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago II)*, 264 Ill. App. 3d 403, 405, 636 N.E.2d 704 (1st Dist. 1993) (rider appropriate "for recovery of costs that are uncertain in duration, timing or amount"); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago I)*, 13 Ill. 2d 607, 150 N.E.2d 776 (1958) (accepting rider to accommodate fluctuating wholesale rates for natural gas).

Second, Illinois courts have permitted riders to recover such pass-through cost items as expenses or fees required by statute or ordinance to all ratepayers or a subset of customers. *See Citizens Util. Bd.,* 166 Ill.2d at 138-139*; City of Chicago v. Illinois Commerce Comm'n,* 281 Ill. App. 3d 617, 627 (1st. Dist. 1996) (*City of Chicago III)* (rider recovery of franchise fees to be charged to residents of municipalities assessing the fees did not constitute single-issue ratemaking). *See City of Chicago II*, 264 Ill. App. 3d at 410 ("Rider 28 allows Edison to look to those who cause costs to pay for them.")

Statutorily, the Public Utilities Act provides only a few exceptions for utility cost recovery outside of rate case proceedings. *See, e.g.,* 220 ILCS 5/9-220(a) (2008), 220 ILCS 5/9-220.1 (2008), 220 ILCS 5/9-220.2 (authorizing surcharges for fuel, environmental remediation, and water and sewage infrastructure costs). More recently, the Legislature authorized rider recovery of energy efficiency program expenses (220 ILCS 5/8-103(e), 220 ILCS 5/8-104(e)) and incremental bad debt (220 ILCS 5/19-145).

In the instant docket, Peoples does not attempt to argue that its Rider ICR fits into any of these judicially recognized or statutorily authorized categories appropriate for rider treatment. The capital costs associated with an accelerated main replacement program are neither "*unexpected, volatile or fluctuating"*

expenses. *A. Finkl & Sons Co. v. Ill. Commerce Comm'n*, 250 Ill. App. 3d 317, 327 (1st Dist. 1993). Indeed, there is nothing unexpected or volatile about a capital improvement project under the Company's control. Likewise, rider recovery of an accelerated main replacement expense is not authorized by statute. The General Assembly specifically authorized such rider treatment for water and sewer utilities infrastructure only. 220 ILCS 5/9-220.2. The expense associated with financing main gas distribution infrastructure replacement is more or less, the nuts and bolts of a gas distribution utility operation. These expenses are not appropriate for rider recovery under the notion that they are more appropriately allotted to a small subset of customers, like the franchise fees in the *City of Chicago III* case referenced above, or would in any way facilitate "direct recovery of a particular cost, without direct impact on the utility's rate of return." *Citizens Utility Board,* 166 Ill.2d at 137-138.

Peoples' Rider ICR proposal constitutes nothing less than single-issue ratemaking. As noted above, the Commission must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single issue ratemaking. *BPI II,* 146 Ill.2d at 195. Instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, PGL's Rider ICR proposal considers changes in infrastructure investment in isolation, ignoring the totality of circumstances and thereby constituting illegal single-issue ratemaking. . In addition, Mr. Marano admitted during cross that the $6,000 savings estimate to be incorporated into Rider ICR did not include all "synergies" that might occur as a result of acceleration of main replacement. Tr. at 845. He admitted, "So there's opportunities for significant savings that weren't factored in." *Id.* The fact that the $6,000 savings figure that will be reflected in customer rates for every mile of CI/DI main replaced can be revisited every few years 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). If approved, Rider ICR would violate the Act's prohibition against single-issue ratemaking by imposing a surcharge each month on customers' bills based on forecasted levels of infrastructure investment for the coming year, without examining whether the Company's overall cost of service and revenue requirement have increased. Given this legal infirmity, the Peoples' proposed Rider ICR should be rejected.

Rider ICR also violates the Commission's test year rules. The purpose of the test-year rule 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. *BPI I,* 136 Ill.2d at 219. 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, therefore, is subject to test-year principles.

Riders 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. 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. Accordingly, Rider ICR is illegal under the Commission's test year rules.

It should be noted, too, that rider recovery of a return of and on infrastructure investments is the ratemaking equivalent of adding plant to rate base, as would occur in a rate case. Under Section 9-211 of the Act, only utility plant that is used and useful and prudently incurred can be recovered in rates. 220 ILCS 5/9-211. Peoples' Rider ICR proposal, if adopted, requires a finding by the Commission that the proposed distribution investment is prudent. Such a finding is not credible given the dearth of evidence to support a specific implementation plan and Mr. Marano's admission that he did not evaluate Peoples CI/DI main in an effort to identify which main should be prioritized for accelerated replacement. Tr. at 808.

Rider ICR, too, raises retroactive ratemaking concerns. Section 9-201 of the Public Utilities Act ensures that rates for utility service are set prospectively. 220 ILCS 5/ 9-201. The Illinois Supreme Court has held repeatedly that the Public Utilities Act does not permit retroactive ratemaking; that is 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. *BPI I,* 136 Ill.2d at 209; *Citizens Utilities Co. v. Illinois Commerce Comm'n,* 124 Ill. 2d 195, 207; 529 N.E.2d 510 (1988).

The rule prohibiting retroactive ratemaking is consistent with the prospective nature of the Commission's legislative function in ratemaking. In addition, this rule promotes stability in the ratemaking process. *Citizens Utilities Co. v. Illinois Commerce Comm'n*), 124 Ill.2d 195, 207, 529 N.E.2d 510 (1988). PGL's proposed rider ICR violates the prohibition in the Act against retroactive ratemaking. Rider ICR would generate monthly surcharges based on a forecasted level of investment in six plant accounts for a particular 12-month period. PGL Ex. VG-1.0 at 35-36. A retroactive adjustment of customer rates would occur in an annual reconciliation proceeding. *Id.* at 36. This retroactive adjustment of rates is not unlike the review ruled illegal in the aforementioned *Finkl* decision, wherein the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudency review, calling it a violation of the rule against retroactive ratemaking. *Finkl,* 250 Ill.App.3d 317 at 329.

Given the absence of both specific statutory authority authorizing the adjustment of customer rates to reflect accelerated replacement of cast iron main for gas distribution utilities on a monthly basis, and Illinois case law regarding ratemaking and riders, it is clear that Peoples' proposed Rider ICR is illegal. The

Company's proposal fits none of the exceptions permitted under law for adopting this extraordinary ratemaking mechanism and, as such, is hereby rejected.

EXCEPTION NO. 2

THE PROPOSED ORDER'S CONCLUSION THAT THE COMPANY CAN BE TRUSTED TO IMPLEMENT MAIN REPLACEMENT ACCELERATION WITH RIDER ICR IS CONTRADICTED BY THE RECORD EVIDENCE.

The Proposed Order asserts that Staff witness Harry Stoller, the ICC's Director of the Energy Department, wants the Commission to order PGL to "conduct the accelerated main replacement program as outlined in Mr. Marano's testimony." PO at 183. In fact, as discussed further below, Mr. Stoller did not recommend that Mr. Marano's cost/benefit analysis serve as the blueprint for acceleration. The Proposed Order also finds that Mr. Stoller requests that PGL should be required to present a fully-developed plan for acceleration and obtain ICC approval of the plan in a docketed proceeding, with the plan analyzed by an independent consultant and to further provide an updated analysis every three years to be analyzed by an independent consultant. PO at 183.

In analyzing these requests, the ALJs make the baffling conclusion at page 194 of the Proposed Order that "a band-aid will not suffice in the situation where a cut is in serious need of stitching." PO at 194. Presumably, this rhetorical flourish suggests that the ALJs have concluded that the PGL CI/DI main replacement should be accelerated. Yet, within the next page, when weighing the decision to adopt Staff's proposal to order the Company to accelerate CI/DI main replacement pursuant to Section 8-503 of the Act, the Proposed Order interprets Section 8-503 to require "a new formal proceeding", that

might lead to an outcome that would require the Company to implement an acceleration program, and lead to a continuing series of rate cases. PO at 195. The Proposed Order concludes that the prospect of a Section 8-503 proceeding is burdensome for both the Commission and the parties. And yet, the Proposed Order opines, "all of this would be occurring at a point and in a situation where Staff itself views time as of the essence." PO at 195.

The most efficient way to ensure acceleration, according to the Proposed Order, is the approval of Rider ICR. PO at 195. Here again, the Proposed Order confuses a revenue recovery mechanism with a commitment to and specific plan for acceleration. Rider ICR is neither. This confusion is betrayed when the Proposed Order states:

> Indeed, the subject matter of Rider ICR is virtually the same as what Staff proposes, i.e., an accelerated modernization plan. The features of the ICR mechanism provide for the near (sic) the same quality of reporting and oversight that Staff would be having us require."

PO at 195.

There are several comments that must be made given these findings.

First, if the Commission believes acceleration is appropriate and necessary based on the existing evidentiary record, then it can order the Company to accelerate CI/DI main replacement pursuant to Section 8-503. 220 ILCS 5/8-503. The Proposed Order is wrong in concluding that another hearing would be necessary to make such a finding. The People have never disputed that acceleration in general makes sense from a safety and reliability perspective. In no way have they called for maintaining "the status quo" as the Proposed Order argues. PO at 196. But the Commission must not assume that the desired acceleration will occur by approving Rider ICR.

Of course, the Proposed Order does just that, and makes several faulty observations and findings that threaten to ensure only that PGL is able to assess monthly customer surcharges for a rate of main replacement that is *slower* than its most recent average of 45 miles per year, with no specific commitment to acceleration of main replacement.

The Proposed Order's recitation of Mr. Stoller's position is not entirely correct. He did *not* express a preference for any particular acceleration end date or endorse Mr. Marano's analysis as an implementation plan. Tr. at 904. Instead, he clarified his testimony to be:

> 1. Peoples should be ordered by the Commission to conduct an in-depth study of the proposed accelerated CI/DI main replacement program "since the program appears to be necessary for the long term safety of Peoples Gas' natural gas distribution system.
>
> 2. Peoples should present the Commission with a fully-developed plan for carrying out the accelerated main replacement program and obtain Commission approval of that proposed plan in a docketed proceeding before commencing the program, with the plan to be analyzed by an independent consultant to be retained by the Commission at PGL's expense prior to Commission approval.
>
> 3. Following Commission approval of PGL's plan for the main replacement program, Peoples should be ordered to return to the Commission with an updated analysis of the program every three years indicating the progress of the program to date, and plans of or the remainder of the program if those plans have changed since the last periodic analysis, the update to be analyzed by an independent consultant retained by the Commission at PGL's expense.

ICC Staff Ex. 14.0 at 2. Mr. Stoller made clear that he was not necessarily endorsing the 2030 completion date highlighted in Mr. Marano's testimony. Tr. at 904. Mr. Stoller also 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.

Mr. Stoller conducted no cost/benefit analysis of his own, nor any sort of evaluation of the risk associated with maintaining the current infrastructure replacement plan. He took no position on Rider ICR. It is important to note, too, that Mr. Marano's cost/benefit analysis was not an examination of specific replacement needs in PGL's CI/DI system. He admitted that he did not attempt to identify, prioritize or evaluate the mains in the PGL system that are ripe for retirement from a safety and reliability perspective. Tr. at 808-809. Likewise, neither Mr. Stoller nor Mr. Marano examined what the revenue requirement impact would be on both the Company and the ratepayers should a 2030 completion date be adopted by the Company. *See* ICC Staff Ex. 14.0 at 1-7; Tr. at 822-825. Mr. Stoller argued instead that the Company should be required to submit a specific implementation plan to the Commission that can be monitored on a regular basis. *Id.* at 2.

Nevertheless, the ALJs opine that "accelerated system improvement has become for the Commission a matter of the public interest more so than just a company proposal." PO at 196. But, again, "the Company proposal" is nothing more than a revenue recovery mechanism.

In response to Mr. Stoller's request for the filing of a specific implementation plan, Mr. Marano submitted a document as an exhibit to his surrebuttal testimony that he described as "a guide" or "an action plan for execution." Tr. at 836. Contrary to the assessment of the ALJs, this "guide" in no way constitutes a specific "implementation plan." PO at 196. The ALJs note that the "plan" was only submitted in surrebuttal

testimony, days before the hearings began, but nevertheless endorse it as an implementation plan. However, 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 *2030* date. Tr. at 835-837; NS/PGL Ex. SDM-3.1. As surmised by Mr. Marano himself, "The actual execution of it still needs to be – it's going to be an evolving process over the next couple years." Tr. at 836.

In assessing the Marano surrebuttal filing, the ALJs assert that neither Staff nor the AG "discuss anything about the Marano plan." PO at 196. The Proposed Order also protests that "nothing prevented any party from asking Mr. Marano either the most general or any specific questions about the plan at hearing." *Id.* These statements misstate the record, as well as the burden of proof in a rate case. First, both the AG Initial and Reply brief commented that the Marano "plan" was insufficient to constitute an implementation plan of any kind. AG Initial Brief at 46-47; AG Reply Brief 19-21. And for the record, the People did, in fact, conduct cross-examination on Mr. Marano's surrebuttal filing. Tr. at 835-837. There, Mr. Marano admitted that his surrebuttal filing is not an execution plan, and that it in no way identifies or prioritizes what main should be prioritized for replacement. *Id.*

Certainly, 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 2030 timeline. . Mr. Stoller's conclusion that

the Marano testimony should not constitute the basis for endorsement of a *2030* deadline is clear:

> If Peoples Gas had followed the recommendation of the Zinder Report of thirty years ago, we would likely not find ourselves today in a situation where Mr. Marano is recommending an "accelerated" cast and ductile iron main replacement program. …What I do know is that the Commission has no process in place today, nor sufficient resources to institute a process, for continuing oversight of the main replacement program that is in any way equivalent to what I have seen work in other circumstances and what I am recommending in this situation. I believe that the Commission should not permit itself to be found in a similar position a decade or two from now; that is, with yet another recommendation for a "hurry-up" program.

ICC Ex. 28.0 at 5-6. Again, the Proposed Order, however, points the finger at Staff and Intervenors for not presenting "evidence to show that outside consultants are necessary and no shred of evidence indicating that Peoples Gas cannot or will not plan and implement an accelerated main replacement program in a reasonable and prudent manner." PO at 197. Again, the inadequacy of the surrebuttal Marano filing speaks for itself. It is not an implementation plan. Its author admits, "It should be noted that at this stage, we have identified what actions PGL should undertake, but not how these actions should be accomplished." NS-PGL Ex. SDM-3.1 at 21. The fact that the Company admits it will cut CI/DI main replacement from 2009 to 2010 in half likewise speaks to the Company's lack of a commitment to acceleration. *See* NS-PGL Ex. ED-2.0 at 5.

To be clear, the People recommended that if the Commission concludes that the existing main replacement schedule should be accelerated based on the record evidence, it 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

2030 completion date as well as Mr. Rubin's testimony about the ratemaking effects of the 2030 completion date, any plan adopted should extend beyond the Marano-recommended timeline.

Further, any such plan must include a study of 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[6], 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.[7] AG Initial Brief at 46-47, AG Reply Brief at 19-21.

The importance of monitoring such a plan cannot be underestimated, as it is in the Proposed Order. Again, confusion permeates the finding that monitoring is not needed and "the Company's Rider ICR proposal is far ahead of the curve." PO at 197. Rider

[6] Historically, at least one-third of PGL's main replacement work stems from projects being undertaken by the City of Chicago. NS-PGL Ex. SDM-3.1. It remains to be seen how the City's budget crisis will affect that factor in PGL's main replacement program.

[7] 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)

ICR is not a main replacement monitoring mechanism. Nor is the surrebuttal "guide" submitted by Mr. Marano, as noted above.

The record shows there is no current PGL commitment to acceleration (given its insistence that a plan not be approved in this docket), no specific implementation plan, and a forecasted decline in main replacement investment. The Proposed Order's findings, however, would have the Commission reward the Company with a revenue collection tool that is not and never has been needed, at a time when many ratepayers are struggling financially. The Commission should reject this inexplicable outcome.

PROPOSED LANGUAGE:

In accordance with the arguments presented above, the Commission should strike the entire "Commission Analysis and Conclusion" beginning at the bottom of page 194 through page 197 and replace it with the following language:

Commission Analysis and Conclusion

Staff witness Harry Stoller testified that he believed it was time for the company to present the Commission with some sort of accelerated CI/DI main replacement implementation plan. ICC Staff Ex. 14.0 at 2. Specifically, he recommended that:

1. Peoples should be ordered by the Commission to conduct an in-depth study of the proposed accelerated CI/DI main replacement program "since the program appears to be necessary for the long term safety of Peoples Gas' natural gas distribution system.
2. Peoples should present the Commission with a fully-developed plan for carrying out the accelerated main replacement program and obtain Commission approval of that proposed plan in a docketed proceeding before commencing the program, with the plan to be analyzed by an independent consultant to be retained by the Commission at PGL's expense prior to Commission approval.
3. Following Commission approval of PGL's plan for the main replacement program, Peoples should be ordered to return to the Commission with an updated analysis of the program every three years indicating the progress of the program to date, and plans of or the remainder of the program if those plans have changed since the

> last periodic analysis, the update to be analyzed by an independent consultant retained by the Commission at PGL's expense.

ICC Staff Ex. 14.0 at 2. In his testimony, Mr. Stoller made clear, however, that he was not necessarily endorsing the 2030 completion date highlighted in Mr. Marano's testimony. Tr. at 904. Mr. Stoller also 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.

In analyzing Mr. Stoller's proposal, we note that he conducted no cost/benefit analysis of his own, nor any sort of evaluation of the risk associated with maintaining the current infrastructure replacement plan. He also did not examine what the revenue requirement impact would be on both the Company and the ratepayers should a 2030 completion date be adopted by the Company. *See* ICC Staff Ex. 14.0 at 1-7. Mr. Stoller argued instead that the Company should be required to submit a specific implementation plan to the Commission that can be monitored on a regular basis. *Id.* at 2.

In response to Mr. Stoller's request for the filing of a specific implementation plan, Mr. Marano submitted a document as an exhibit to his surrebuttal testimony that he described as "a guide" or "an action plan for execution." Tr. at 836. However, 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 2030 date. Tr. at 835-837; NS/PGL Ex. SDM-3.1. As surmised by Mr. Marano himself, "The actual execution of it still needs to be – it's going to be an evolving process over the next couple years." Tr. at 836. This surrebuttal filing lacks any kind of detail that the Commission believes would be necessary to monitor and ensure that acceleration of main replacement takes place.

Mr. Marano's cost benefit analysis, presented as support for its proposed Rider ICR, can likewise not form the basis of the Commission establishing any certain main replacement completion date. Mr. Marano admitted that his cost/benefit analysis was not an examination of specific replacement needs in PGL's CI/DI system. He admitted that he did not attempt to identify, prioritize or evaluate the mains in the PGL system that are ripe for retirement from a safety and reliability perspective. Tr. at 808-809. Likewise, neither Mr. Stoller nor Mr. Marano examined what the revenue requirement impact would be on both the Company and the ratepayers should a *2030* completion date be adopted by the Company. *See* ICC Staff Ex. 14.0 at 1-7; Tr. at 822-825.

Mr. Marano examined three different timing scenarios for acceleration: 2025, 2030 and 2035. Tr. 809; PGL Ex. SDM-1.0 at 50, 51. Mr. Marano concluded that a 2030 completion date would be the "most practical and economical" of the three choices. Tr. at 810. Mr. Marano then compared that

replacement time frame with the current schedule, which would complete infrastructure replacement of Peoples' CI/DI main system in about 49 years. Tr. at 810; PGL Ex. SDM-1.0 at 52-53. Mr. Marano stated that his cost/benefit analysis concluded that "there is a net benefit from the accelerated investment in cast iron and ductile iron main replacement for PGL, based on the assumptions in our analysis and the estimates of certain key parameters provided by PGL." PGL Ex. SDM-1.0 at 54. His analysis did not make any assumptions as to whether revenues to help finance the project came from base rate revenue increases or Rider ICR. Tr. at 842-843.

The critical elements in this analysis, not surprisingly, relate to the assumptions made by Mr. Marano in his evaluation. First, he assumed that inflation would grow by 1.8 percent each year for the 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 twice 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.

Mr. Marano's assumptions trigger significant differences in assumed construction costs between his preferred 2030 scenario and the current 2059 completion date. That's because, again, Mr. Marano's assumption that materials costs will increase at 1.7 times the rate of inflation and that labor costs will increase at 2.2 times the rate of inflation occur under the Company's modeling each and every year. 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.

Putting aside the appropriateness of the assumptions used in the cost benefit analysis presented, what is perhaps most striking and troubling about the Marano recommendation is that Peoples itself cannot explain how such a plan could be accomplished given the drastically reduced rate of main replacement forecasted for 2009 and 2010. As detailed by PGL witness Edward Doerk, the Company has gone from an average annual replacement rate of 45 miles in 2008 (AG/CUB Ex. 3.06), considered typical for the Company (Tr. at 589), to a 20-mile average for 2009 and a 10-mile estimate for 2010. *See* NS/PGL Ex. ED-2.0 at 5. Mr. Marano testified that he rejected adoption of a 2025 completion date because "replacing 154 miles of main per year is more than three times the current replacement rate and deemed not practical" in his opinion. PGL Ex. SDM-1.0 at 50. Indeed, Mr. Marano's direct testimony stated that his preferred acceleration plan would require the then replacement rate of 45 miles-per-year to more than double. PGL Ex. SDM-1.0 at 72. Adoption of Mr. Marano's 2030 completion date, however, would require Peoples to step up main replacement from the forecasted 10 miles per year to 114 miles per year, or *more than 11 times* the

amount replaced in forecasted 2010. Tr. at 831-833. Mr. Marano testified that a five-year ramp up would be incorporated into a 2030 completion plan. PGL Ex. SDM-1.0 at 73. Tr. at 833. He confirmed during cross-examination, however, that the Company's updated forecast of main replacement was not incorporated into either his overall cost benefit analysis or the reference to a five-year ramp up. Tr. at 830. Mr. Marano admitted that he "didn't look at, per se, the financial, the business aspects" of how a necessary ramp up would occur. Tr. at 833-34. He admitted, too, that he did not conduct any kind of an analysis of the revenue requirement effects of Commission adoption of a 2030 main replacement deadline. Tr. at 822-828.

The change in the Company's forecasted main replacement numbers for 2009 and 2010 would not only impact the practical task of completing main replacement by 2035. Mr. Marano himself admitted that these changes in the rate of main replacement affect the bottom line numbers produced in his cost benefit analysis. Tr. at 840-841. All of this evidence supports rejection by the Commission at this point in time of any specific timeline for completion of CI/DI main replacement.

Other problems infuse the Marano analysis. First, Mr. Marano's overall conclusion that a 2030 completion date would result in approximately $158 million in construction cost savings and $248 million in future O&M cost savings is flawed. PGL Ex. SDM-1.16; NS/PGL Ex. SDM-2.0 at 12. His analysis did *not* consider the cost of capital or the depreciation of that capital in his comparison of a 2030 completion date with the existing 2059 date, both of which "are critically important to any comparison of different investment options." Tr. at 1007. AG/CUB witness Rubin noted that Mr. Marano's analysis treated every dollar expended, whether for capital or operating expenditures, as being equivalent, an assumption that Mr. Rubin explained was critically flawed because it fails to recognize the difference in terms of dollars paid by customers over time. Tr. at 1008. As Mr. Rubin explained, Mr. Marano's cost benefit analysis fails to take into account the revenue requirement effect of capitalizing O&M expenses associated with the infrastructure replacement that Rider ICR incorporates within its authorized surcharge assessment. *Id.*

For example, Mr. Marano observed that $159.7 million in capitalized O&M to be paid under Rider ICR is much less than the O&M expense savings of $244 million that the Company would realize if it embarked on a 2030 acceleration completion date. However, Mr. Marano failed to acknowledge that using Peoples' assumptions about the cost of capital and depreciation rate on this investment, customers would be required to pay $228.4 million for these capitalized costs from 2011 through *2030*, as shown on AG/CUB Ex. 6.01. Moreover, at the end of *2030*, there still would be more than $135 million in capitalized costs on Peoples' books (i.e. undepreciated investment). This amount, Mr. Rubin explained, would continue to earn a return and incur depreciation expense for many years into the future. AG/CUB Ex. 6.0 at 2.

Mr. Rubin's own comparison of the Company's annual estimate of cost savings under a 2030 acceleration end date with the revenue requirement for the capitalized O&M costs shows that the total O&M expense savings during this

period, as projected by Peoples, is approximately $99.6 million. AG/CUB Ex. 6.01 In contrast the revenue requirement associated with the capitalized O&M costs is approximately $228.4 million. *Id.* The net effect is that customers would be required to pay an additional $128.8 million in rates over the 19-year period of the proposed accelerated replacement program. Mr. Rubin noted, too, that capitalized O&M is just one component of investment that Peoples proposes to recover through Rider ICR. AG/CUB Ex. 6.0 at 3.

Mr. Rubin also took issue with Mr. Marano's statement that "gross savings" from the accelerated replacement program would be $432 million, and that subtracting capitalized O&M from that figure would create net savings of $272.3 million, as asserted by Mr. Marano in his rebuttal testimony. NS-PGL Ex. SDEM-2.0 at 11-12. Mr. Rubin explained that the $432 million in savings is construction-related savings estimated by the Company over a 49-year period, which has ratemaking consequences:

> The problem, once again, is that this fails to consider how much customers would be required to pay in rates to support this capital investment. (Mr. Marano's) Scenario 3 (the accelerated program) spends the entire $2.47 billion over a 19-year period. Scenario 2 (the current program) spends $2.90 billion over a 49-year period. The impact of each of these expenditure streams on revenue requirements is very different, especially when the additional $159.7 million in capitalized O&M (also spent over 19 years) is considered.

AG/CUB Ex. 6.0 at 4.

Even if Mr. Marano is correct about labor and materials costs increasing faster than the rate of inflation over the next 49 years, customers would not see a savings of $432 million over time on their bills, as Mr. Marano asserts at page 12 of his rebuttal testimony. As pointed out by Mr. Rubin, what customers see on their bills depends on the annual return of and return on that capital investment. *Id.* at 5. There is a big difference between the amount invested in capital in any given year and the effect that has on customers' bills (and utility company revenues). AG/CUB Exs. 6.05 and 6.06, attached to Mr. Rubin's rebuttal testimony, calculate the annual revenue requirement associated with the capital investment Mr. Marano used to develop the $432 million in construction cost savings, supplemented with the revenue requirements associated with the $159.7 million in capitalized O&M costs that Mr. Marano did not include in his cost analysis. *Id.* As discussed further in part E. below, these exhibits dispute Mr. Marano's assertion that customers would see a savings of $432 million on their bills over time.

In short, Mr. Marano's recommendation of a 2030 end date is both impractical and unrealistic as a timeline for main replacement, given the record evidence. Neither the cost/benefit analysis nor the Marano "guide" submitted in the Company's surrebuttal case provide the Commission with the kind of information it needs to be assured that the Company will accelerate CI/DI main

replacement. The analysis simply does not justify Commission approval of the proposed Rider ICR.

Perhaps the worst indictment of Mr. Marano's analysis and his preferred 2030 completion date for main replacement can be found in Mr. Rubin's unrebutted comparison of the total revenue requirement effect of Mr. Marano's preferred 2030 date and the 2059 date that exists under the current accelerated main replacement plan. AG/CUB Exhibit 6.05 shows the revenue requirements associated with Peoples' current main replacement program. As explained by Mr. Rubin, the total capital-related revenue requirement (that is, pre-tax return and depreciation) associated with continuing this program through the year 2059 (the end year of the existing acceleration program) is $8.87 billion. *Id.* at 5-6. On Exhibit 6.06, Mr. Rubin shows that the comparable figure for Mr. Marano's recommended 2030 end-date accelerated program, including the capitalized O&M that would be collected under Rider ICR, is $11.94 billion. *Id.* at 6. Thus, contrary to the assertions in Mr. Marano's rebuttal testimony that customers would the Marano-calculated savings "in part through Rider ICR and in part through traditional ratemaking," when a proper revenue requirement analysis is performed that compares the costs customers actually would pay *and the revenue the Company actually would receive,* 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.

Importantly, Mr. Schott did not dispute Mr. Rubin's comparison of the revenue requirements associated with the 2030 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. Even when that expense amount is incorporated into the analysis ($3 million x 49 years, or $147 million), Mr. Marano's preferred 2030 date ends up costing ratepayers in excess of $3 billion more than current main replacement practice.

Mr. Schott likewise confirmed that even with Rider ICR, the Company's overall revenue requirement will increase under the Marano-recommended completion date. Tr. at 63-68. Mr. Schott further suggested that the Commission can expect Peoples and North Shore to file for frequent rate relief through the rate case process – a pattern all the more likely given the extraordinary growth in revenue requirements that the Marano-recommended 2030 acceleration end date would demand:

> "The Company – Integrys' position with regard to its regulated utilities, including Peoples Gas and North Shore Gas, is we to expect earn our authorized return. And to the extent revenues are insufficient for us to earn that authorized return, we will file rate cases as needed."

Tr. at 63. The significant increase in revenue requirements triggered by a 2030 acceleration date, along with the Companies' position that "we expect to earn our authorized return," and will file rate cases as needed, are arguments against approving Rider ICR. As Mr. Rubin noted and Mr. Schott agreed, the filing of a rate case presents the Commission with an opportunity to review all of the Company's expenses and revenues. Tr. at 68. And to the extent that the test year recognizes changes in or additions to plant, the test year process also captures the efficiencies that reduce operating costs associated with new investment. Tr. at 68-69. Even if Peoples launches an aggressive main replacement program, the need for revenue relief – with or without a rider – will trigger regular rate filings. At that time, the additional plant that the Company has invested in can be incorporated in the rate base, assuming it is used and useful and prudently incurred, and the revenue requirement will be adjusted accordingly. The record evidence shows no justification for burdening ratepayers -- and the Commission Staff obligated to review the rider filings -- with rider cost recovery of infrastructure investment.

One additional problem arises under a 2030 acceleration end date scenario – a problem unforeseen and not evaluated by Mr. Marano. As pointed out by Mr. Rubin, once the main replacement is completed in a 20-year time frame under a 2030 scenario, and given the 60-to-70 average life of the plant that is being replaced, a substantial portion of the Peoples distribution system would be failing within the same 20-year time frame, thus setting the company on a permanent track of rapidly accelerated main replacement. Tr. at 998. Instead of stretching out investment over 50 years, as the current plan does, replacement would be compressed over 20 years under the 2030 plan. Mr. Rubin explained the problem as follows:

> Once you accelerate the investment, collapse 50 year worth of investment into 20 years, as Peoples is proposing, that is going to create another accelerated investment problem 60 or 70 years into the future.

Tr. at 1013. As such, the Commission, and ratepayers will be placed on a course of perennial acceleration of infrastructure replacements with a 20 year time frame for a substantial portion of the Company's infrastructure.

For all of these reasons, the adoption of Mr. Marano's preferred 2030 timeline for accelerated main replacement is both unrealistic and inequitable to ratepayers.

As noted above, 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. Again, Mr. Marano's surrebuttal plan does not provide that essential information. Tr. at 837. Based on Mr. Stoller's direct and rebuttal testimony, and pursuant to Section 8-

503 of the Public Utilities Act, the Commission hereby orders the Company to first hire an independent consultant to analyze 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. It is clear that the Marano-recommended 2030 deadline is unworkable from a revenue requirements perspective. It is also clear that Staff witness Stoller did not consider the revenue requirement effect of a 2030 deadline in his support for such an abbreviated timeframe. Finally, any plan should provide specific detail about employment needs for both union and non-union workers under any approved implementation schedule.

EXCEPTION NO. 3:

THE AG'S ADJUSTMENT FOR THE DOWNWARD TREND IN THE PRICE OF NATURAL GAS SHOULD BE ACCEPTED BECAUSE IT INCORPORATES ALL OF THE FACTORS CITED BY THE COMPANY RATHER THAN ISOLATING ONE.

AG witness Effron recommended an adjustment to the Companies' sales forecasts which increased Peoples' test year revenues by $15.553 million and North Shore's test year revenues by $2.839 million. AG/CUB/City Ex. 4.0 at 8. In reaching his adjustment, Mr. Effron took the sales forecasts provided by the Companies and updated it with more recent natural gas prices provided by the Companies in response to AG and Staff data requests. AG/CUB/City Ex. 1.0 at 14-15; AG/CUB/City Ex. 4.1 and 4.2. The only change Mr. Effron made to the Companies' sales forecasts was to adjust the price of natural gas, an update supported by Staff witness Harden. See Staff Ex. 24.0 at 18. The Companies object on the grounds that Mr. Effron's proposed adjustment isolates one factor of many which affect sales. This is true. Presumably, however, the Companies'

own sales forecasts – the numbers used by Mr. Effron in calculating his adjustment – would be reflective of factors such as "efficiency improvements" and trend in large volume consumer consumption. AG Initial Brief at 17. The information updating the Companies' sales forecasts for the downward price of natural gas is in the record and as such, should be relied upon by the Commission in this proceeding. Accordingly, the AG's proposed adjustment should be adopted.

PROPOSED LANGUAGE:

The Proposed Order should be modified on page 89 as follows:

d) Commission Analysis and Conclusion

~~Mr. Effron's proposal improperly selects one factor out of the sales models to update and ignores all other factors.~~ The Commission notes evidence presented by the Utilities that Mr. Effron did not update the "Efficiency Improvements" group of variables, which includes the state of the economy and is more powerful than the price factor and drives down usage per customer. NS-PGL Ex. DWC-2.0 at 1, 2-5; NS-PGL Ex. DWC-3.0 at 1-2. Because of timing, the economic downturn was not captured in the Utilities' sales forecasts used in their filings. Updating all of the variables, not just a single results-driven factor, would perhaps result in lower sales forecasts. ~~Although it would probably have been helpful for the Utilities to have updated everything based on the drop in the price of gas, that evidence is not before us. The record as it stands does not support the AG's adjustment.~~ Mr. Effron's adjustment, based on the Utilities own sales forecasts which include, among other things, the "Efficiency Improvements" cited by Mr. Clabots, simply updates the sales forecasts with the most recent natural gas price data available. As such, the adjustment proposed by the AG is adopted.

EXCEPTION NO. 4.

THE PROPOSED ORDER'S CONCLUSION TO DIFFERENTIATE CUSTOMER CHARGES BETWEEN SALES AND TRANSPORTATION CUSTOMERS BASED ON ACCOUNT 904 SHOULD BE REJECTED.

The Proposed Order incorrectly adopts the Companies' proposal to create different customer charges based on the NS-PGL witness Grace's testimony that these costs were assigned in the Companies' ECOSS to the customer function, Customer Accounts category. PO at 211. The People concur with the Staff assessment that these costs result from an unpaid bill, and that unpaid bill is composed of three parts – the customer charge, distribution charge and demand charge. Staff Ex. 10.0 at 5-6. This position is consistent with the Commission's order in the Companies' last rate case, as noted by Staff witness Harden.

The Proposed Order notes the perceived advantage of minimizing the number of differentiated Rider VBA charges that are reflected on customer bills by reflecting the Account 904 expense allocation in the customer charge. PO at 211. However, the pilot should not be used as a basis for permanently adjusting customer charges and creating this confusing differential. Rider VBA may not exist after the pilot runs its course. There simply is no good reason based on cost causation principles or public policy reasons to create this cost allocation distinction, as discussed in the Exceptions to the Customer Charge section below.

PROPOSED LANGUAGE

In accordance with the arguments set forth above, the Commission Analysis and Conclusion appearing on pages 211 and 212 should be stricken and replaced with the following:

The Utilities' request to set different customer charges based on NS-PGL witness Grace's testimony that these costs were assigned in the Companies' ECOSS to the customer function, Customer Accounts category, will create unnecessary confusion among sales and transportation customers. The Commission concurs with the Staff assessment that these costs result from an

unpaid bill, and that unpaid bill is composed of three parts – the customer charge, distribution charge and demand charge. Staff Ex. 10.0 at 5-6. This position is consistent with the Commission's order in the Companies' last rate case, as noted by Staff witness Harden.

The Companies note the perceived advantage of minimizing the number of differentiated Rider VBA charges that are reflected on customer bills by reflecting the Account 904 expense allocation in the customer charge. However, the pilot should not be used as a basis for permanently adjusting customer charges and creating this confusing differential. Rider VBA may not exist after the pilot runs its course. There simply is no good reason based on cost causation principles or public policy reasons to create this cost allocation distinction. The Companies' proposal in this regard is denied. In addition, there are public policy reasons for not making such a change, as discussed below in the Customer Charge section for rates 1 and 2 of this Order.

EXCEPTION NO. 5:

PEOPLES' PROPOSAL TO ASSESS DIFFERENT CUSTOMER CHARGES FOR BUNDLED SALES AND TRANSPORTATION CUSTOMERS, AS WELL AS INCREASED FIXED COST RECOVERY THROUGH THESE CHARGES, SHOULD BE REJECTED.

At page 217 of the Proposed Order, the ALJs make two findings that should be reversed by the Commission. First, the Proposed Order accepts the Companies' proposal to increase fixed cost recovery in the customer charge for the rates 1 and 2 classes to 55% for North Shore and 54% for Peoples. Proposed Order at 218. In doing so, the Proposed Order simply concludes that it has increased fixed cost recovery in other recent cases, and that the increases requested by the Companies are not as high as approved for other utilities. The Proposed Order also concludes that different customer charges should be assessed for bundled sales customers and transportation customers. Transportation customers is another name for ratepayers who purchase their gas supply from alternative retail gas suppliers ("ARGs"). The existing single customer charge for sales and transportation customers should be retained.

On the issue of fixed cost recovery, the percentage of fixed costs recovered through the customer charge should not be increased because the VBA Pilot is intended to address fixed cost recovery. Staff witness Harden recommended that the Commission retain the existing single customer charge for both sales and transportation customers, and further recommended that the charge be set at 50% of the class revenue requirement determined in the docket. Staff Initial Brief at 160. AG/CUB witness Scott Rubin agreed that in the 2007 Peoples/North Shore rate cases, the Commission approved decoupling mechanisms (Rider VBA, Volume Balancing Adjustment) for both Utilities for a four-year pilot period that will end with the March 2012 filing. PO at 232. As Staff correctly pointed out, the Rider VBA pilot is intended to address the Companies' recovery of fixed costs. Staff Initial Brief at 160. Allowing the Companies to recover a higher percentage of fixed costs through the customer charge would change the dynamics of the pilot program. *Id.* As the Proposed Order notes on page 225, "now, while Rider VBA is in place and being reviewed, is not the time to institute new rates that would make that review impractical."

The point that is ignored in the Proposed Order is that Rider VBA ensures that the Company receives all of its "fixed costs" – which include the Company's profit level as defined in the 2008 Order. Increasing fixed cost recovery in the customer charge is a solution in need of a problem. Staff's recommendation to preserve the integrity of the pilot by rejecting a proposed increase to the Companies' customer charges to recover additional fixed costs should be adopted.

Finally, the conclusion that disparate customer charges should be assessed for bundled and ARGs customers is simply poor public policy, as explained by AG/CUB

witness Scott Rubin. He recommended that uncollectible costs associated with nonpaying sales customers should be paid for by all paying customers, not just bundled customers. Tr. at 1018. He noted that the costs of nonpaying customers are a social cost, which are typically spread across rate classes. He noted:

> We've decided that paying customers should pay for nonpaying customers as long as the utility is prudently trying to minimize the amount of the uncollectible. What the Company (sic) is now proposing is to only make paying sales customers pay for the nonpaying customers. And in my opinion, that's not an appropriate public policy. We shouldn't be letting transportation customers off the hook for that social obligation, and I'm also concerned about what that might mean down the road.
>
> It's creating a strong incentive for paying customers to leave bundled service and take transportation service. So that if we carry this out for 5 or 10 years, it could be the only customers we have left taking bundled service are paying and troubled customers, and then who's going to pay the costs? The cost either falls on the utility's shareholders or we have to rethink the whole process we've gone through. But I just think it's a very poor public policy to say we're only going to have paying customers pay for nonpaying sales customers.

Tr. at 1017-1018.

The only reason the Companies identified for having a lower distribution rate for Transportation customers is to remove the responsibility from those customers to pay for uncollectible accounts expenses associated with gas purchased by sales customers. The Companies already have the ability to assess different rider surcharges between sales and transportation customers for incremental bad debt expenses above the level approved in rate recovery under the new uncollectibles rider law passed last Spring. 220 ILCS 19-145. It simply is not necessary to require this distinction in the customer charge. Making such a change will cause customer confusion, too. As noted by Mr. Rubin, given this law, "there would be no need to reflect any difference in base rates between Sales and Transportation customers." AG/CUB Ex. 2.0 at 15-16. The Companies' base rates

should be established for residential customers without regard to whether a customer purchases gas from the Companies.

PROPOSED LANGUAGE:

The Proposed Order on page 220 should be modified as follows:

(3) Commission Analysis and Conclusion

~~As discussed under the Account 904 issue, it is appropriate to have different customer distribution charges for sales and transportation customers. The findings in this section do not change that determination.~~

Before addressing the specific proposals raised, it is important to recognize that Rider VBA will remain in place until March 2012. At that time, Rider VBA will terminate unless the Utilities request an extension and the Commission approves the request.

The Utilities propose to increase the proportion of fixed costs that will be recovered through the customer charge. The Utilities are correct that the Commission has been increasing the proportion of fixed costs recovered through the customer charge in other proceedings. *See Nicor 2008*; *In re Central Illinois Light Co., Central Illinois Public Serv. Co. and Illinois Power Co.*, Dockets 07-0588/07-0589/07-0590 (Consol.) (Order, Sept. 24, 2008). The Commission notes that the Utilities' proposal does not approach the level of fixed costs approved in those dockets. Staff argues, however, that it is inappropriate to change the manner in which the Utilities' fixed costs are recovered while the Rider VBA pilot is in place. We ~~do not~~ agree. ~~The Utilities inform us that sufficient activity will remain under Rider VBA for purposes of reviewing its effect during the pilot period. Moreover, in the event that Rider VBA is not renewed, the slight increase proposed by the Utilities' here will be a benefit in the long run.~~

As Staff correctly pointed out, the Rider VBA pilot is intended to address the Companies' recovery of fixed costs. Staff Initial Brief at 160. Allowing the Companies to recover a higher percentage of fixed costs through the customer charge would change the dynamics of the pilot program. *Id.* Now, while Rider VBA is in place and being reviewed, is not the time to institute new rates that would make that review impractical."

The point that is ignored by the Companies is that Rider VBA ensures that the Company receives all of its "fixed costs" – which include the Company's profit level as defined in the 2008 Order. Increasing fixed cost recovery in the customer charge is a solution in need of a problem. Staff's recommendation to preserve the integrity of the pilot by rejecting a proposed increase to the Companies' customer charges to recover additional fixed costs should be adopted.

On the issue of differing customer charges, the Commission agrees with Mr. Rubin's conclusion that the assessment of disparate customer charges for bundled and ARGs customers is simply poor public policy. As noted by Mr. Rubin, the costs of nonpaying customers are a social cost, which are typically spread across rate classes. The notion that paying customers should pay for nonpaying customers as long as the utility is prudently trying to minimize the amount of the uncollectible has been regulatory policy for years. What the Companies now propose is to only make paying sales customers pay for the nonpaying customers. That result creates a strong incentive for paying customers to leave bundled service and take transportation service.

The only reason the Companies identified for having a lower distribution rate for Transportation customers is to remove the responsibility from those customers to pay for uncollectible accounts expenses associated with gas purchased by sales customers. The Companies already have the ability to assess different rider surcharges between sales and transportation customers for incremental bad debt expenses above the level approved in rate recovery under the new uncollectibles rider law passed last spring. 220 ILCS 19-145. It simply is not necessary to require this distinction in the customer charge. Making such a change will cause customer confusion, too. The Companies' proposal in this regard is hereby rejected.

CORRECTION NO. 1:

The Proposed Order quotes AG witness Scott Rubin (AG/CUB/City Ex. 2.0 at 12) but incorrectly identifies the witness as AG witness David Effron. The Proposed Order on page 228 should be modified as follows:

> Mr. ~~Effron~~ Rubin testified that "[d]emand-related costs are those that vary with the maximum usage that a customer places on the system. Demand-related costs are reflected in the sizing of

> distribution mains, storage facilities, and other types of distribution facilities and related operations and maintenance costs." AG/CUB/City Ex. 2.0 at 12. Currently, and under the Utilities' proposal, demand-related charges do not vary with the amount of gas a customer uses. The AG proposes to collect demand related costs on a per therm basis.

CONCLUSION

WHEREFORE, for the aforementioned reasons, the People of the State of Illinois request that the Commission issue its Final Order pursuant to the modifications recommended herein.

Respectfully Submitted,

The People of the State of Illinois
By LISA MADIGAN, Attorney General

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Janice A. Dale, Chief, Public Utilities Bureau
Karen L. Lusson, Senior Assistant Attorney General
100 W. Randolph St., 11th Floor
Chicago, IL 60601
Telephone (312) 814-3736
Fax (312) 814-3212
Email: jdale@atg.state.il.us
Email: klusson@atg.state.il.us